Limitations on Upside Profit Potential under Alaska’s Oil and Gas Production Tax (“The Problem with ACES”)

Roger Marks
Presentation to Board of Directors
Commonwealth North
December 14, 2010
Tax Rate under ACES

• Base rate of 25% of net value (after deducting all costs)
• Progressivity element when net value per barrel exceeds $30/bbl:
  – \((\text{Net value per barrel value} - $30) \times 0.004\)
  – So if oil price is $85/bbl:
  – Net value per barrel is about $56/bbl
  – Progressivity = ($56 - $30) \times 0.004 = 10.4%
  – Total tax rate = 25% + 10.4% = 35.4%
  – APPLIES TO ENTIRE NET VALUE
U.S. Tax Rate for Single Taxpayer

- First $8,350  10%
- Next $25,600  15%
- Next $48,300  25%
- Next $89,300  28%
- Next $201,400  33%
- Anything over $372,950  35%
What Happens to the First Dollar of Value under ACES

Net Value per Barrel ($/bbl)
Marginal Tax Rate under ACES (All State & Federal Taxes & Royalties)

How Much Gov't Gets When Price Goes Up $1

Marginal Tax Rate

ANS Market Price ($/bbl)
Conceptual Net Present Value to Producers
ACES vs. Bracketed Tax Structure

NPV to Producers ($)
Price ($/bbl)

ACES Tax Structure
Bracketed Tax Structure
Hypothetical Expected Price Distribution

- **Probability of Certain Price**
- **Oil Price ($/bbl)**
Getting a Fair Share
Fair Share: Maximum Benefit to the People

- Assume this is the long-run benefit
- Maximizing long-run benefit linked to maximizing long-run production
- Long run production of oil & gas can only be maximized by continual investment
- Alaska competes with other jurisdictions for investment
What is the Fair Share

• “The World is Flat”
  – Capital is fluid
  – Capital is finite
  – Capital goes to where it gets the best deal

• What is “fair” is what you can get in a competitive environment

• Have to consider how investing in Alaska stacks up against other investment opportunities
International Competitiveness
Where did $100/bbl in Alaska Go in 2008?

- Producers: $20
- Costs: $24
- State & Federal Government: $56
ConocoPhillips Financial Performance: Alaska vs. Rest of World
2008 & 2009 ($millions)*
(Oil Prices averaged $62/bbl in 2009 and $100/bbl in 2008)

<table>
<thead>
<tr>
<th></th>
<th>Alaska</th>
<th>Non-Alaska Rest of World</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2009</td>
<td>2008</td>
</tr>
<tr>
<td>Pre-tax income</td>
<td>3,391</td>
<td>7,064</td>
</tr>
<tr>
<td>Total taxes</td>
<td>1,851</td>
<td>4,749</td>
</tr>
<tr>
<td>After-tax income</td>
<td>1,540</td>
<td>2,315</td>
</tr>
<tr>
<td>Percentage of additional pre-tax income retained after-tax</td>
<td>21%</td>
<td>51%</td>
</tr>
</tbody>
</table>

* includes natural gas
International Marginal Tax Rates @ $100/bbl Market Price
Tax & Royalty Regimes

Marginal Tax Rate @ $100/bbl

U.S. GOM  | U.K.  | Alberta | Thailand | Australia | Brazil | Norway | Alaska - ACES
0% | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% | 90%
International Effective Tax Rates
(Total Tax / Net Value)

ANS Market Price ($/bbl)

- U.S. GOM
- U.K.
- Alberta
- Thailand
- Australia
- Brazil
- Norway
- Alaska - ACES
Evaluating ACES
Gold-Plating
How Much of a Dollar of Spending is Picked Up by Gov't

ANS Market Price ($/bbl) vs. Marginal Tax Rate
Fixing ACES
How **NOT** to Fix It:
Mechanisms that Retain Current Structure

• More credits
• Go back to PPT
• Cap progressivity rate
• Reduce base rate
Cash Flow Impact: Credits vs. ACES Severance Tax

Per Barrel Credit / Severance Tax

ANS Market Price ($/bbl)

per/bbl credits

per/bbl severance tax
Marginal Tax Rate
With Tax Rates Capped at 40% and 50%
Marginal Tax Rate under ACES with a 15% Base Tax Rate
Proposal for Fix: Bracketed Tax Rates
Brackets: Design Considerations

- Base rate
- When progressivity starts
- Number of brackets
- Size of brackets
- Net value for peak
- Peak rate
- All gauged to international competitiveness
Proposed Bracket Structure Based on Net Value p/bbl*

- $0/bbl - $30/bbl 20%
- Next $22/bbl ($30 - $52/bbl) 24%
- Next $21/bbl ($52 - $73/bbl) 29%
- Next $22/bbl ($73 - $95/bbl) 33%
- Next $22/bbl ($95 - $117/bbl) 37%
- Next $21/bbl ($117 - $138/bbl) 41%
- Next $22/bbl ($138 - $160/bbl) 46%
- Anything over $160/bbl 50%

* These net values are approximately $30 less than market values (the ANS West Coast price).
## Example: $130/bbl ANS Market Price

<table>
<thead>
<tr>
<th>Market Price</th>
<th>$130</th>
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<tbody>
<tr>
<td>Costs</td>
<td>$30</td>
</tr>
<tr>
<td>Net Value</td>
<td>$100</td>
</tr>
</tbody>
</table>

### Bracketed Tax

<table>
<thead>
<tr>
<th>Dollars in Tax</th>
<th>Rate</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bracket 1: $0/bbl - $30/bbl</td>
<td>$30</td>
<td>20.0%</td>
</tr>
<tr>
<td>Bracket 2: Next $22/bbl ($30-$52/bbl)</td>
<td>$22</td>
<td>24.0%</td>
</tr>
<tr>
<td>Bracket 3: Next $21/bbl ($52-$73/bbl)</td>
<td>$21</td>
<td>29.0%</td>
</tr>
<tr>
<td>Bracket 3: Next $22/bbl ($73-$95/bbl)</td>
<td>$22</td>
<td>33.0%</td>
</tr>
<tr>
<td>Bracket 3: Next $5/bbl ($95-$100/bbl)</td>
<td>$5</td>
<td>37.0%</td>
</tr>
</tbody>
</table>

**Bracketed tax per barrel** $26.48
Marginal Tax Rate
ACES & Proposed Bracketed

Marginal Tax Rate

ANS Market Price ($/bbl)

ACES
Bracketed