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)	
	Equals value at point of production			23,405.6	
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)	
{	*Equals* PTV (Production Tax Value)			16,631.9	
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)
	Sums to Production Tax			(6,984.7)	6,984.7
{	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 of 20 mills on oil and gas property		From RSB:		358.3
	Note: may be difference between cost incurred and allowable costs		Subtotal	9,041.43	10,874.5
		Note Federal taxes @ 35%		(3,164.50)	3,164.50
		Totals		5,876.93	14,038.98
		Percentage of destination Value		24%	56%

9.14.2009

Production Tax 201 – “Higher Of” Destination Value

- <u>“Higher of” under AS 43.55.020 (f)</u>

- Start of netback is higher of sales price at destination or “value of the oil or gas of the same kind, quality and character prevailing for that field or area during the calendar month…”
- 15 AAC 55.171 defines “prevailing value” for ANS oil delivered to the west coast as average spot derived from average of *Platts, Telerate* and *Reuters* reporting services

- Note: Many state leases also have a similar higher of provision pertinent to royalty

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Production Tax 202 –"Lower" of Transportation Costs

- AS 43.55.150
- Previously: Actual cost unless
  - 1) Shipper affiliated with carrier
  - 2) Contract for transportation not arms length
  - AND
  - 3) Method of transportation not reasonable
- 2007 change: AND becomes OR
- If condition 1, 2, or 3 present:
  - Lower of actual or reasonable cost
  - TAPS carriers mostly affiliates of producers
  - Tanker fleet owned by captive or partially captive shipping companies.

Production Taxes 202 - "Lower of" Transportation Costs

- New AS 43.55.150 (b);
- (b) If the department finds that a condition in (a)(1), (2), or (3) of this section is present, the gross value at the point of production is calculated using the actual costs of transportation, or the reasonable costs of transportation as determined under this subsection, whichever is lower. The department shall determine the reasonable costs of transportation, using the fair market value of like transportation, the fair market value of equally efficient and available alternative modes of transportation, or other reasonable methods. Transportation costs fixed by tariff rates that have been adjudicated as just and reasonable by the Regulatory Commission of Alaska or another regulatory agency and transportation costs in an arm's length transaction paid by parties not affiliated with an owner of the method of transportation shall be considered prima facie reasonable.

- <u>For Marine Tankers between Valdez and West Coast</u>
- Under proposed departmental approach reasonable and actual costs will typically be the same for tankers shipping oil -
- Affiliation:
  - Actual costs
  - With cost of capital allowance including depreciation, return of and on capital, and income tax allowance (ROI Manual)

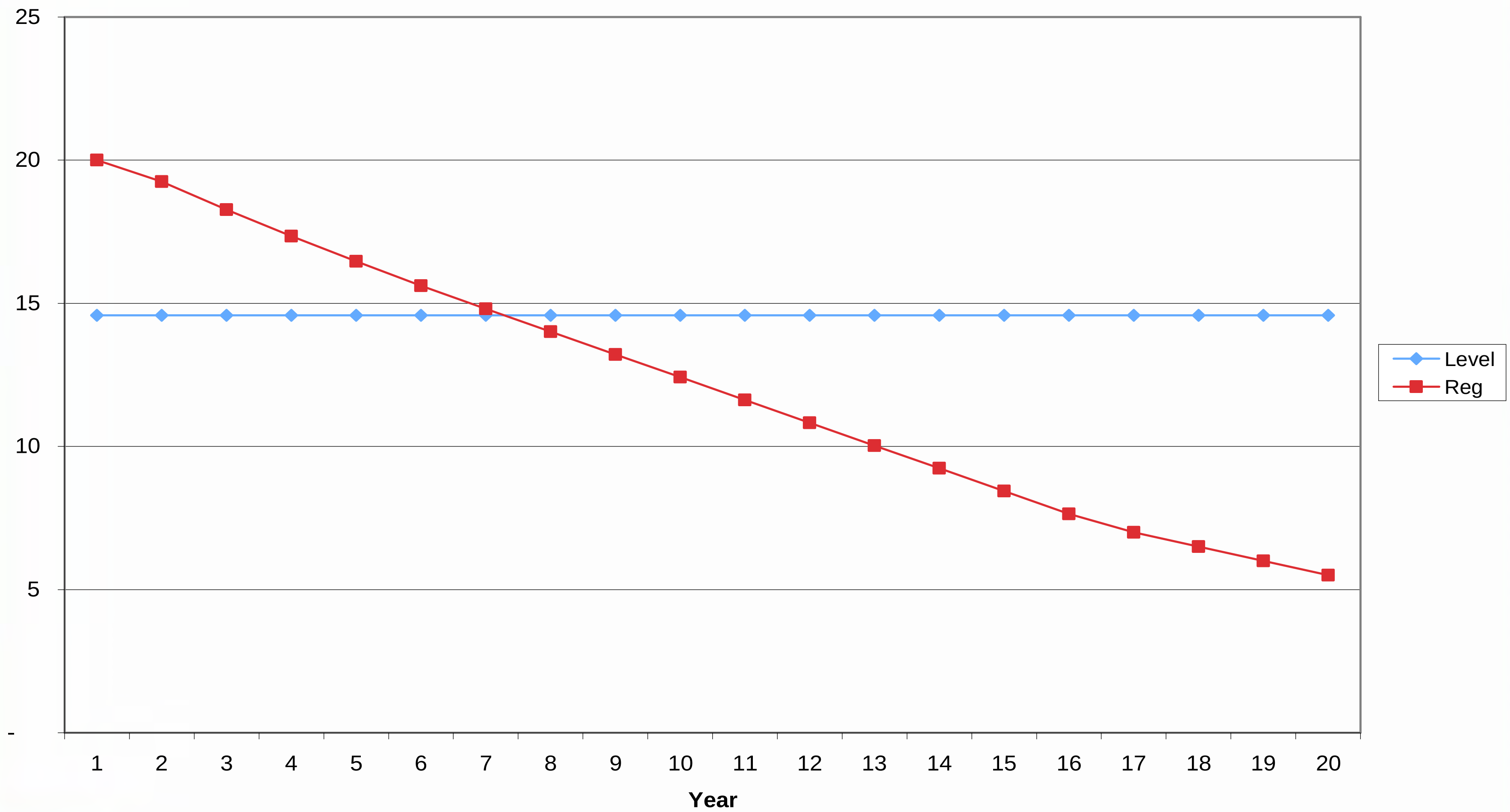
Production Taxes 202 - "Lower of" Transportation Costs

- For Pipelines (TAPS)
- Because of regulated tariffs, actual and reasonable costs will be derived differently, and may diverge
- Again, for affiliates, lower of actual/reasonable
- Tariffs adjudicated as just and reasonable considered prima facie reasonable
- For non-affiliated shippers tariff itself will continue to be reasonable cost
- Issues for Pipelines
  - When to trigger actual / reasonable comparison
  - What are reasonable costs
  - Comparison of actual / reasonable
  - Transition from actual to reasonable, when appropriate
  - Transition back from actual to reasonable, when appropriate

Production Taxes 202 - "Lower of" Transportation Costs

- <u>Early draft of regulations:</u>
- Out of pocket costs including Ad Valorem Tax
- Cost of Capital allowance includes depreciation, return on capital, income tax allowance
  - DOR uses levelized (mortgage) approach
    - Different than regulatory methods
- Floating tax, cost of capital (WACC)
- After-tax WACC based on regulated pipelines published by Morningstar (Ibbotson)
- Allowance
  - Unrecovered investment
  - Less NPV of tax depreciation benefits
  - Divided by annuity factor
  - Gross-up for income taxes
- Amount recovered per year:
  - Unrecovered investment less (allowance minus income tax)

Cost of Capital: Levelized vs. Regulatory



Source: Roger Marks, DOR, Master Class on Alaska Taxes, Fourth Annual Oil and Gas Conference

Dan E. Dickinson CPA

Production Taxes 202 - "Lower of" Transportation Costs

- Should "reasonable costs" require mini rate cases?

- Footnote: AS 43.55.150 also applies to gas
- Producers have additional uncertainty as to how they will be allowed to calculate the deductibility of tariff.

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Royalties 101

- <u>Royalties are in a contract with the landowner:</u>
- State owned land – State Royalties (which are exempted from production tax) (i.e. 7/8ths taxable)
- Federally owned land in state – Federal Royalties (which are exempted from production tax) (i.e. 7/8ths taxable) and all other state taxes apply.
  - (Royalties may be shared with State under federal legislation)
- Federally owned land not in state (off shore - outer continental shelf) Federal Royalties and no state taxes apply.
  - (Note; in Gulf Of Mexico (GOM) federal royalties now shared with Gulf coastal states.)
- Privately owned land in state – Private Royalties (which are taxable at betwen1.667 to 5% of gross) while other 7/8ths taxable under regular production tax and all other taxes apply.

AK State Royalties 101

Source: Kevin Banks presentation to House Finance Committee (Jan 22, 2008)

AK State Royalties 101

- In the lease – include both gas and oil
- Measured at point of production
- Older State leases 12.5% royalty
- Some newer leases have higher rates (average ~13%)
- Less field cost allowance in legacy fields such as Kuparuk and Prudhoe.
- Can be taken in kind (oil or gas) or value (money)
- Also some Net Profit Share Leases