Fundamentals: Overview FY 2008

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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%

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Production Tax 206 - Credits

- Credits under AS 43.55.023 and AS 43.55.025 generally can be
  - Transferred (sold) to another person (for application no sooner than half in year issued, half in later year)
  - Saved and applied against future liabilities
  - Sold to the state under certain conditions
    - For companies producing less than 50,000 bbls a day
    - reinvesting in Alaska per terms found in AS 43.55.028
    - Note: Original annual cap of $25 million per taxpayer in repurchases was repealed in 2007

- <u>Credits under AS 43.55.023</u>
- AS 43.55.023 (a) investment credit of 20% of qualified capital investment.
  - Only half can be taken in year of investment
- AS 43.55.023 (b) loss carry forward credit calculated as 25% of lease expenditures “not deductible in calculating PTV”
  - If transferred must be used over two years
- AS 43.55.023 (e) credit purchased from other company may not reduce tax to less than 80% of would otherwise be due
- AS 43.55.023 (i) TIE credits – now generally repealed

Production Tax 206 - Credits

- "New Area Development" Credit under AS 43.55.024 (a) - (b)
- Up to $6 million a year against PTV from a New Area Development (not North Slope, not Cook Inlet)

- "Small Producer" Credit under AS 43.55.024 (c) - (d)
- Up to $12 million a year applicable against AS 43.55.011(e) taxes
- If not more than 50,000 BTU equivalent bbls a year
  – Phases out between 50,000 and 100,000 bbls
  – 1- [2 X (AP – 50,000)]/ 100,000

- All AS 43.55.024 credits:
- Non transferable, non saleable, can't carry over
- Sunsets in 2016
  – Or if no production before 2006, but production starts before 2016, then 9 years of the credit.

- Test under AS 23.44.024 (e):
  – A producer must demonstrate… that its operation in the state … would not result in the division among multiple entities of any production tax liability that reasonably would be expected to be attributed to a single producer if the tax credit provisions …did not exist.

Production Tax 206 - Credits

- <u>Credits under AS 43.55.025</u>
- AS 43.55.025 (b) & (c) credit of 30% of exploration costs that have been pre- approved by the commissioner of DNR as new exploration target (must also be more than 3 miles from existing bottom hole, except in CI).
- AS 43.55.025 (b) & (d) credit of 30% of exploration costs more than 25 miles from a 2003 unit boundary
- AS 43.55.025 (b), (c) & (d) credit of 40% of exploration costs that meet both criteria
- AS 43.55.025 (b) & (e) credit of 40% for seismic costs
- AS 43.55.025 (l) credit of 5% for pre 2003 work DNR considers making public in best interest,
- Data generated by activity that created credit becomes public
  - Well data after 2 years
  - Seismic data after 10 years

Fully transferable or salable or can be carried forward.

Production Tax 206 - Credits

Simplified Production Tax Example	Year 1	Year 2 (Start second Project)	Year 3 (Both Projects Profitable)
Destination Value	100.00	100.00	200.00
Less Downstream Costs	(10.00)	(10.00)	(20.00)
Gross Value at the Point of Production	90.00	90.00	180.00
Less Royalty	(11.25)	(11.25)	(22.50)
Less Opex	(10.00)	(10.00)	(20.00)
Less Capex	(10.00)	**(80.00)**	(10.00)
equals PTV (Production Tax Value)	58.75	zero	127.50
Calculation of Loss		(11.25)	
Base Production Tax Rate Credit Conversion	25%	25%	25%
Base Production Tax Dollars	14.69		31.88
Investment Credit (20% over two years)	(1.00)	(9.00)	(9.00)
Loss Carry Forward (Certificated)		(1.41)	(1.41)
Tax Due (Payment from State)	13.69	(10.41)	21.47

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AK Corporate Income Tax 101

- <u>AS 43.20 Alaska Net Income Tax Act</u>
- a corporate income tax (CIT) rate of 9.4% for all income above $90,000.
- Not separate accounting (9.4% of income from an Alaskan project)
- Instead Apportionment which means
  - CIT = 9.4%* AK App Factor * Everywhere Income
    - Where
  - Everywhere income = Federal taxable income plus any taxes based on or measured by net income added back.
  - AK App Factor = the Alaska Apportionment Factor
- For incremental analysis: Most “separate accounting income” generated in the state will be apportioned off and taxed elsewhere; most of the income taxes collected in the state will have been generated from “separate accounting income” generated elsewhere.

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AK Corporate Income Tax 101

All figures in billions of Dollars

Calendar Year 2006 Annual Reports Income before Taxes

EM	67.4
BP	34.6
CP	28.3
Total	130.3
Appx AK Appor Factor	5%
Appx AK Appor Dollars	6.5
AK CIT Rate	9.4%
AK CIT Dollars	0.612

Revenue Sources Book

FY 2006	0.661
FY 2007	0.594
Average	0.628

AK Corporate Income Tax 101

- Oil and Gas Companies have a distinct set of provisions under AS 43.20.072
- For an oil and gas company Alaska Apportionment Factor is average of

- Alaska Production / World Wide Production
- Alaska Property / Worldwide Property
- Alaska Sales / Worldwide Sales

- Everywhere income is worldwide income adjusted by
  - Capitalizing certain intangible drilling and development costs expensed under the IRC
  - Restating depletion
  - Restating depreciation using 1980 federal depreciation rules
- Factors
  - Sales factor includes pipeline tariffs charged affiliates
  - Property factor includes intangible drilling and development costs

AK Corporate Income Tax 101

- Tax can apply to new entrant before project is placed in service.
- Alaska apportionment factor for a company with neither oil or gas production, or without a pipeline, is average of

- Alaska Payroll / US Payroll
- Alaska Property / US Property
- Alaska Sales / US Sales

- Everywhere income is US water's edge domestic income – federal taxable income

- Property in Alaska does not include WIP that has not yet been placed in service

AK Corporate Income Tax 101

- Depreciation of Oil and Gas Assets (compared to current federal rules)

Asset Guideline Class		Lower Limit ADR (Current State rule)	Asset Guideline Period	ACRS Dep period	MACRS Dep period (Current Federal rule)	Macrs Brackets
13.2	Exploration for and Production of Petroleum and Natural Gas Deposits	11	14	5	7	(10 - 16)
13	Offshore Drilling	6	7.5	5	5	(4 - 10)
13.1	Drilling of Oil and Gas wells	5	6	5	5	(4 - 10)
49.23	Natural Gas Production Plant	11	14	5	7	(10 - 16)
46	Pipeline Transportation *	17.5	22	10	15	(20 - 25)
	* Except Alaska Natural Gas Pipeline				7	defined

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AK Corporate Income Tax 101

- Sample Calculation

International Oil Company A
Figures in millions of dollars or barrel equivalents

	Alaska	Everywhere	Ratio
Sales	250	25,000	1%
PPE	4,000	40,000	10%
Production	250	1,000	25%
Alaska Apportionment Factor			12%
Income (before Taxes)			2,500
Alaska Apportioned Income			300
Alaska Tax Rate			9.4%
Alaska Corporate Tax			28.2

Alaska Corporate Income Tax 101

- How best to model incremental effect?
- For a company that knows its worldwide parameters – an incremental analysis is possible.
- For more general analysis, tempting to treat as if the income tax were still separate accounting (This presentation does this several times).
- Another approach is to model the stand alone change in the factors, which directionally may give a better indicator of some of the effects of an incremental project. However, still does not solve the world wide income issue.

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Property Tax 101

- Assessed Value
  - State centrally assess “oil and gas property”,
- Tax
  - State taxes at 2% (20 mills) a year. Allows credit for taxes paid on 43.56 property to localities
  - Localities that have property taxes can apply their general rates against “oil and gas property”, and other property (tankers, office buildings, vehicles etc.)
    - No effective formal cap on local rate
    - Informal caps are state’s 20% rate and local pressures

Property Tax 101

- 3 classes of property
- Exploration property (rigs)
- Production Property
- Pipeline Property

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Property Tax 101

- <u>Exploration property</u>
-
- 1% of 2008 Roll
- AS 43.56.060 (c) & 15 AAC 56.090
- Price property would bring in open market

Property Tax 101

- <u>Production Property</u>

- 62% of 2008 role
- AS 43.56.060 (d) & 15 AAC 56.100
- Actual cost while under construction
- Replacement cost new less depreciation (base on economic life of proven reserves) thereafter

Property Tax 101

- <u>Pipeline Property</u>

- 37% of 2008 role
- AS 43.56.060 (e)
- Actual cost while under construction
- Once in service " with due regard to the economic value of the property based on the estimated life of the proven reserves…"
- 15 AAC 56.110
- "standard appraisal techniques such as replacement cost less depreciation, capitalization of estimated future net income, analysis of sales or other acceptable methods"
- Current department focus is on cost methods

Federal Lands 101

Federal Lands 101

- <u>Production from Federal Lands</u>

- Important to distinguish between land in Alaska owned by the federal government and federal land laying offshore of Alaska

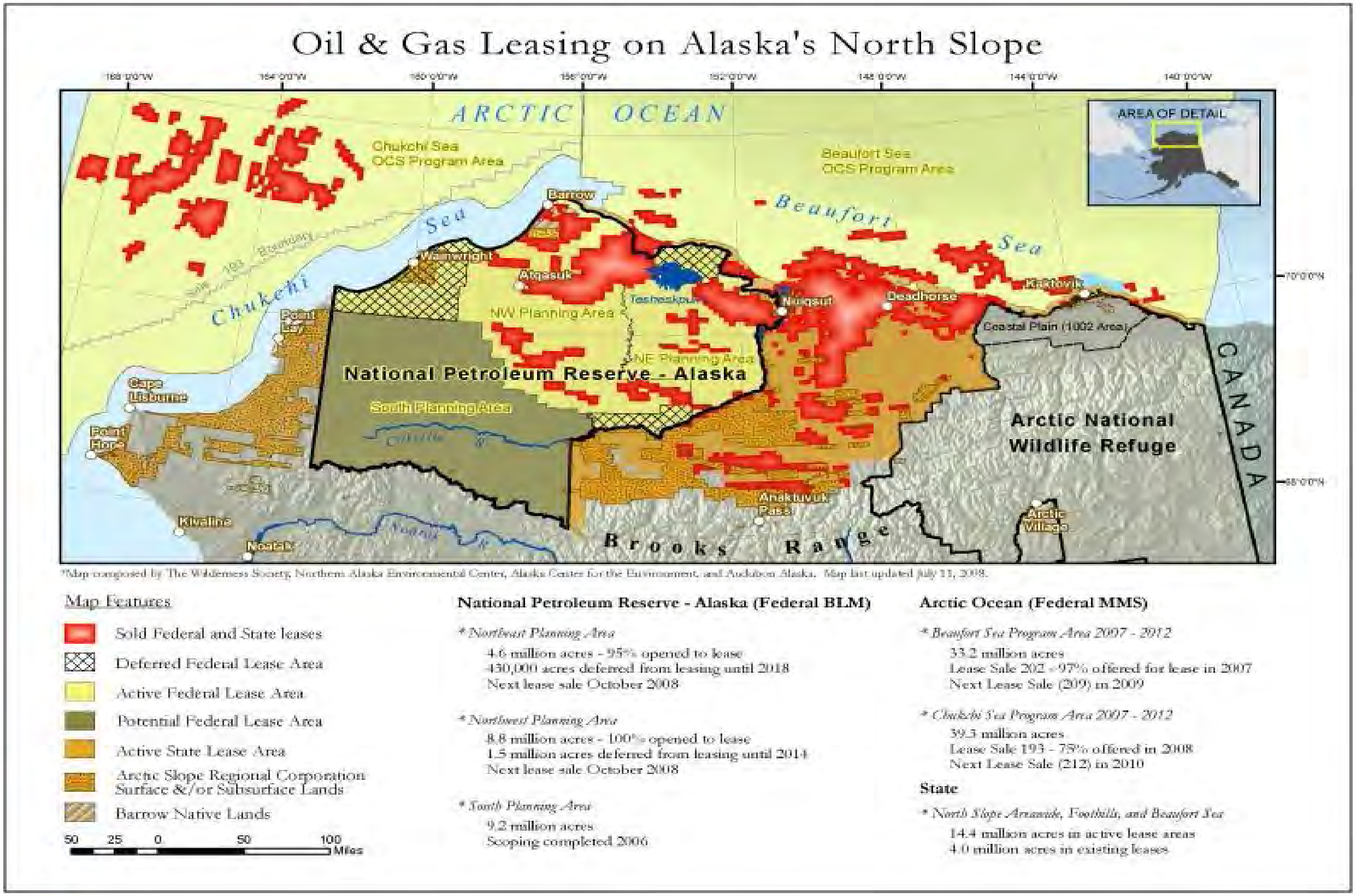
- Royalty is paid to owner of land, whoever that is
- If the land is in Alaska (up to three miles offshore) subject to Alaska Taxes.
- Alaska can’t tax production or activity outside its borders

Federal Lands 101

- State owns from the Canning River to the Colville River

Source: USGS Fact Sheet 2005-3120 Economic Analysis of Undiscovered oil and gas of Central North Slope of Alaska (2005)

Federal Lands 101



Source: The Wilderness Society, 2007

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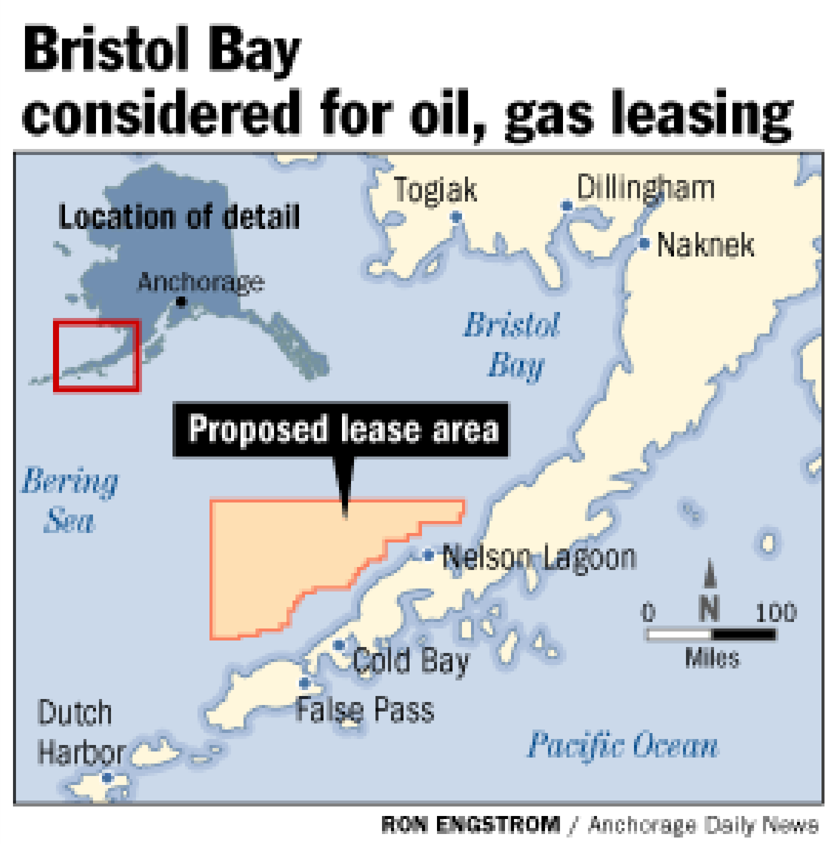
- State held on shore sale in 2007
- Feds considering 2012 sale



Federal Lands 101

Regimes of Some Currently Producing and Other Units

Land In Alaska - owned as			OCS
State	Private	US	US
Colville to the Canning			
NS Producing			
Prudhoe, Kuparuk, Endicott, Alpine*	*part of Alpine		
Northstar*,Badami			*part of Northstar
Oooguruk			
			Beaufort Sea, Chukchi Sea
	*with in holdings	NPRA, ANWR*	
Cook Inlet			
	Swanson River*	Swanson River*	
McArthur River, Middle Ground Shoal, North Cook Inlet, Kenai			
Cannery Loop*		Cannery Loop*	
Beluga River*		Beluga River*	

Federal Lands 101

Four different Tax/Royalty regimes associated with AK

	Land In Alaska - owned as			OCS
	State	Private	US	US
Royalties	State	Per Contract	Federal (shared with state)	Federal (shared with state??)
Production Tax	Yes, except royalty share	Yes, except royalty share subject to separate gross tax under AS 43.55.011(i)	Yes, except royalty share	No
Property Tax	Yes	Yes	Yes	Yes (In state)
State Income Tax	In num, den, income	In num, den, income	In num, den, income	In den, income, may affect num

Other Potential Topics

- Other US Tax Regimes
- Comparison of Alaska with CA, LA, CO, TX, NM, LA, WY, OK and GOM
  - Note Oklahoma, Wyoming and Texas already produced more than 4.5 bcf of gas a day.

Other Potential Topics

- What's up with a gas line from the North Slope of Alaska?

Summary And Take Away

18. Summary and Take Away Points

- First Tree – 20 months after 2007 reforms passed legislature, regulations remain incomplete.

- Second Tree Difficulty in modeling system
- – effect of regulations still not known
  - Monthly progressivity
  - Haircut between actual costs and allowable lease expenditures
  - State Corporate Income Tax

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Summary and Take Away Points

- Third Tree - Will there be a specific push for further tax reforms –particularly as they relate to gas – before the 2011 open seasons currently anticipated by both the TransCanada/ExxonMobil/ AGIA project or the Denali/BP/ConocoPhillips project?
- Perhaps
- – From producer's point of view, if EM bids on one project and BP and CP bid on another, will lead to unsuccessful open season. Probably producers will wait
- - From administration point of view, don't want to "bid against self"
- -Perhaps a legislative initiative?

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Summary and Take Away Points

- Fourth Tree - unprecedented high prices disguised long term volume problems (2 million barrels a day at $17 a barrel vs. 700,000 bbls/d at $50 a barrel)
- Huge implications for state revenues if prices drop, muted because CBRF is flush.
- Captured windfall can help state make it through many years at lower oil prices.
- The 2008 reform <u>worked</u> – less likely to change except perhaps to isolate gas and oil, should there be another price peak.

18. Summary and Take Away Points

- Fifth Tree -
- Immediate focus appears to be on getting energy delivered around then state. Expect a continuing focus on gas, with the incidental payoff of the expected increase in exploration leading to more oil.

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18. Summary and Take Away Points

- Sixth Tree - Legislature more focused on progressivity than administrations.–
  - "The big lesson of the [2007 special] session was the political climate was far more favorable for a tax increase than the governor, the producers and most politicians had guessed" - Gregg Erickson writing in 12/2/07 Anchorage Daily News
- Progressivity
  - Murkowski proposed zero – Legislature enacted .25% per $
  - Palin proposed .2% per dollar – legislature enacted .4% per $

18. Summary and Take Away Points

- First Forest - Distance Gas & Gas Pipeline
- Is the fiscal system appropriate for major gas project?
  - Administration has expressed attitude that if it can be shown that tax structure is inappropriate for distance gas development then they will attempt to address the problem.
  - At current price levels sense of why use carrots – if you look at the pile of cash that, say, Exxon is sitting on , how could another incentive matter?
  - Using constant real rising gas prices over next decades, state's experts have determined that the project is "wildly profitable" and therefore lessees should commit their gas to a project. (FT commitments) So if the current lessees don't commit, and "carrots" are inappropriate, are sticks the next step?
  - Palin Administration suggested more fiscal certainly than legislature allowed in AGIA license.
  - Problem of disentangling "Concessions," "Giveaways," "Tax Breaks," from movement toward productive investment climate

TransCanada's AGIA application suggestion:

- "TransCanada would rely on the State of Alaska to take all feasible actions exclusively within its authority as a sovereign power to ensure a favorable economic environment for potential Shippers on the Project. Those actions include:
- engaging with the ANS producers to reach agreement on a commercially reasonable and predictable upstream fiscal regime that balances the needs of the state and the ANS producers;
- and encouraging robust exploration for and development of new natural gas resources and the commitment of such resources to the Project."

Source: TransCanada, Application for License, Alaska Gasline Inducement Act (November 30, 2007) page 2.5-52

ConocoPhillips' Proposal

- ConocoPhillips' Proposal (ConocoPhillips current owner with BP of Denali Project)

  "The predominant lessee risk that should be the focus of discussion with the State is the risk of unclear, unpredictable State taxes and royalties. In order to enable shippers to make a long term shipping commitments, prospective shippers need clearly defined natural gas fiscal terms and an understanding of the period during which these terms will apply. Addressing these issues remains a critical component necessary to develop ANS natural gas resources and make this Project a reality."

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Source: ConocoPhillips, ANS Natural Gas Pipeline Proposal to the State of Alaska, (November 30, 2007) section IV page 5

ExxonMobil's Observations

- "At some point we will need to align with the state on fiscal and tariff Stability" - Marty Massey (US Joint Interest manager for Exxon Mobil) 7/11/08

- "One of the things you heard me mention time and time again that you need to have predictable and durable fiscal terms. Similar to any other project around the world of this magnitude, that is something that you have to have. - Marty Massey (US Joint Interest Manager for Exxon Mobil) 6/23/09

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Source: Exxon presentations to legislature found at //www.legis.state.ak.us/ssess/7-10-2008 and Reuters.com

- Conclusion – there will be changes to the oil and gas tax regime before a major export line is built – but neither may occur very soon.

18. Summary and Take Away Points

- Next Forest – This is part of a Cycle
- Perception looking back, that merely having “low” taxes did not generate sufficient reinvestment in the state by the large producers or new entrance by new players.
- Widespread belief that era of low taxes (and low prices) did not lead to sufficient investment through 80s and 90s, while also not giving state fair share.
- As prices rose the regressive fiscal system meant that state share did not keep up.

18. Summary and Take Away Points

- Hence a shift from thinking of taxes as a drag on business activity - hence they should be as low as they can be, with the only constraint that state needed sufficient resources to finance government (?without other major taxes.)

- To thinking of the tax system more like a royalty; “Its our oil or gas” so government take should be as high as it can be, with the only constraint that they do not drive away investment.

18. Summary and Take Away Points

- State now very willing to welcome new entrants and for state to take significant part of exploration risk and even development risk
  - Paid for with higher taxes on legacy fields such as Prudhoe Bay, Kuparuk, Alpine.

- With AGIA state willing to underwrite front end capital development of a gas pipeline – with a new player.

- New heroes are the "small independents" – and the opening of Oooguruk and Nikaitchuq.

18. Summary and Take Away Points

- Questions remain about how state will determine what appropriate investment is being made. Short term watch Pt Thomson as a good indicator.
- State will continue to wrestle with problem of "not caving in" vs. trying to act in commercially reasonable fashion.
- Debate can get confused between what is working and what isn't and what's right and wrong.
- Pendulums swing

Thank You

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