

# Petroleum Profits Tax (PPT)

---

## CS for HB 488 (RES) Overview

Alaska Department of Revenue  
Before the House Finance Committee

March 27, 2006

Robynn J. Wilson, Director, TAX Division, DOR

Dan E. Dickinson, CPA

# The Governor's 3 Big Ideas

---

- ❑ The current Production Tax system is broken.
- ❑ We need to use the tax system to encourage investment
- ❑ We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low

# The Governor's 3 Big Ideas

---

- ❑ The current Production Tax system is broken. *The CS also replaces it.*
- ❑ We need to use the tax system to encourage investment. *The CS has incentives for investment*
- ❑ We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low. The CS preserves the Governor's 20/20 structure

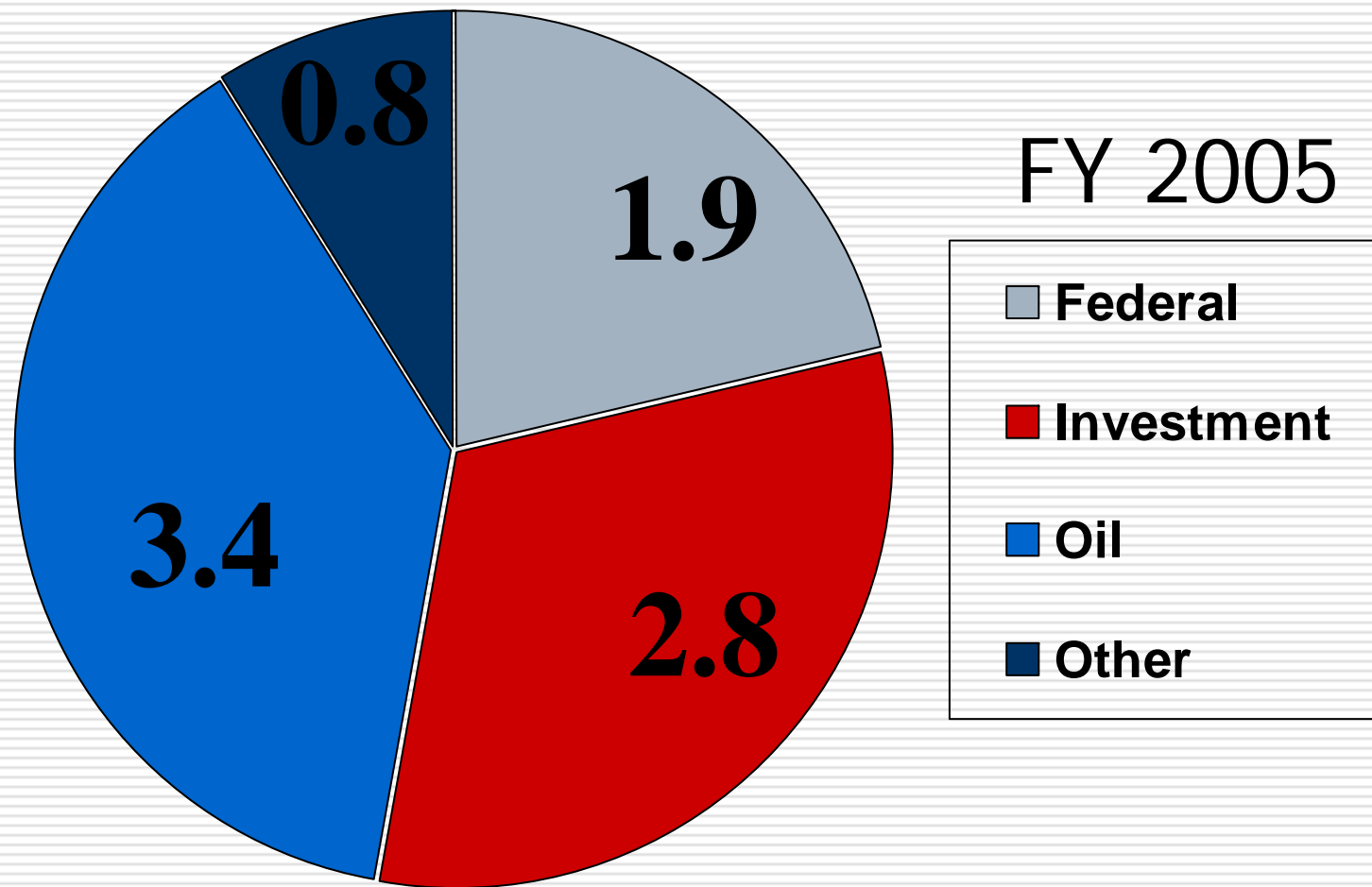
# The Governor's 3 Big Ideas

---

- Idea one: The Production Current Tax System is broken
  - We are not getting the investment we need – could the structure of the Production Tax be to blame
  - We are not getting a fair share of revenues when Prices are high and investment is low

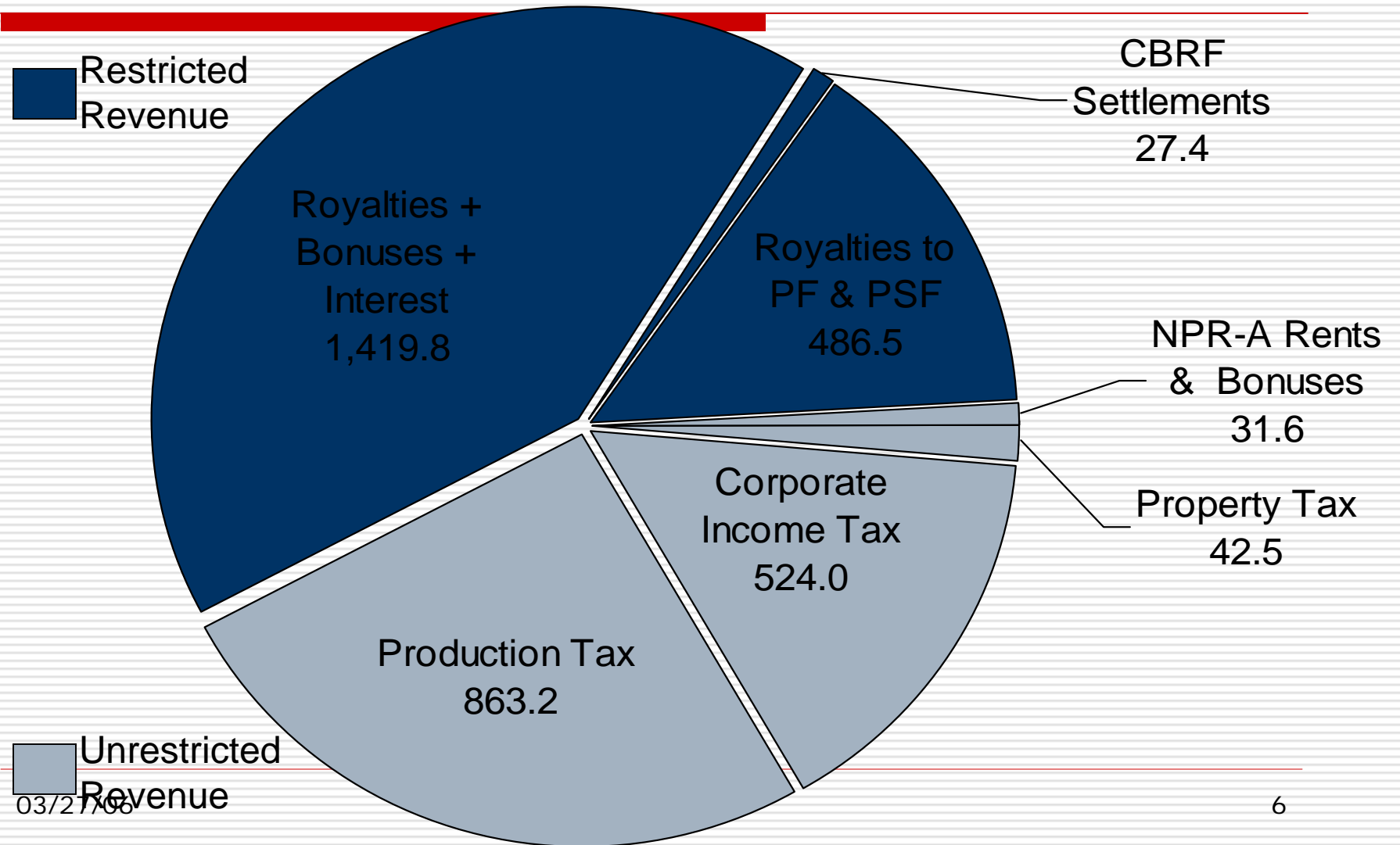
# Unrestricted & Restricted Revenue \$ Billion

---



# FY 2005 Petroleum Revenue

## \$ Million



03/27/06

# 1. Destination Value at Market (2005)

	Volume Millions barrels	\$ per barrel	\$ Million
Destination Value at Market	330	\$43.43	\$14,332
Less Tankering & Pipelines	<u>330</u>	<u>\$ 4.51</u>	<u>(\$1,488)</u>
Gross Value at Point of Production	330	\$38.92	\$12,844
Less Upstream Costs			
Operating:		\$ 3.33	
Capital:		<u>\$ 3.18</u>	
Total	330	\$ 96.52	(\$2,150)
Net Value at Point of Production	330	\$32.40	\$ 10,694

03/10/06

## 2. Current Production Tax

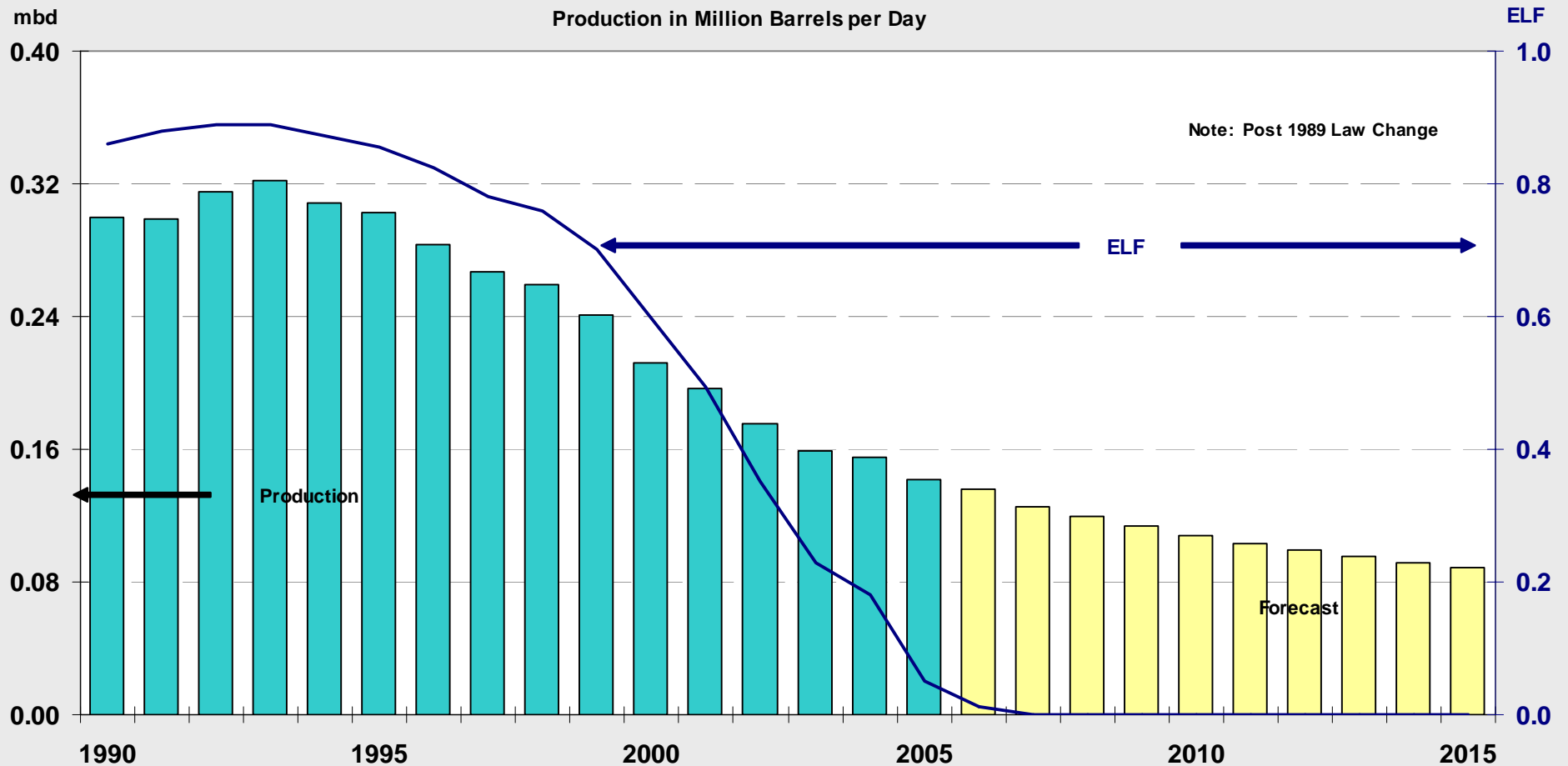
---

	\$ in Billion
Gross Value at Point of Production	\$12,844
1- Royalty Rate	0.875
Value Net of Royalty	<u>\$11,238</u>
Tax Rate	0.15
ELF Rate	0.55
Tax	\$ 927

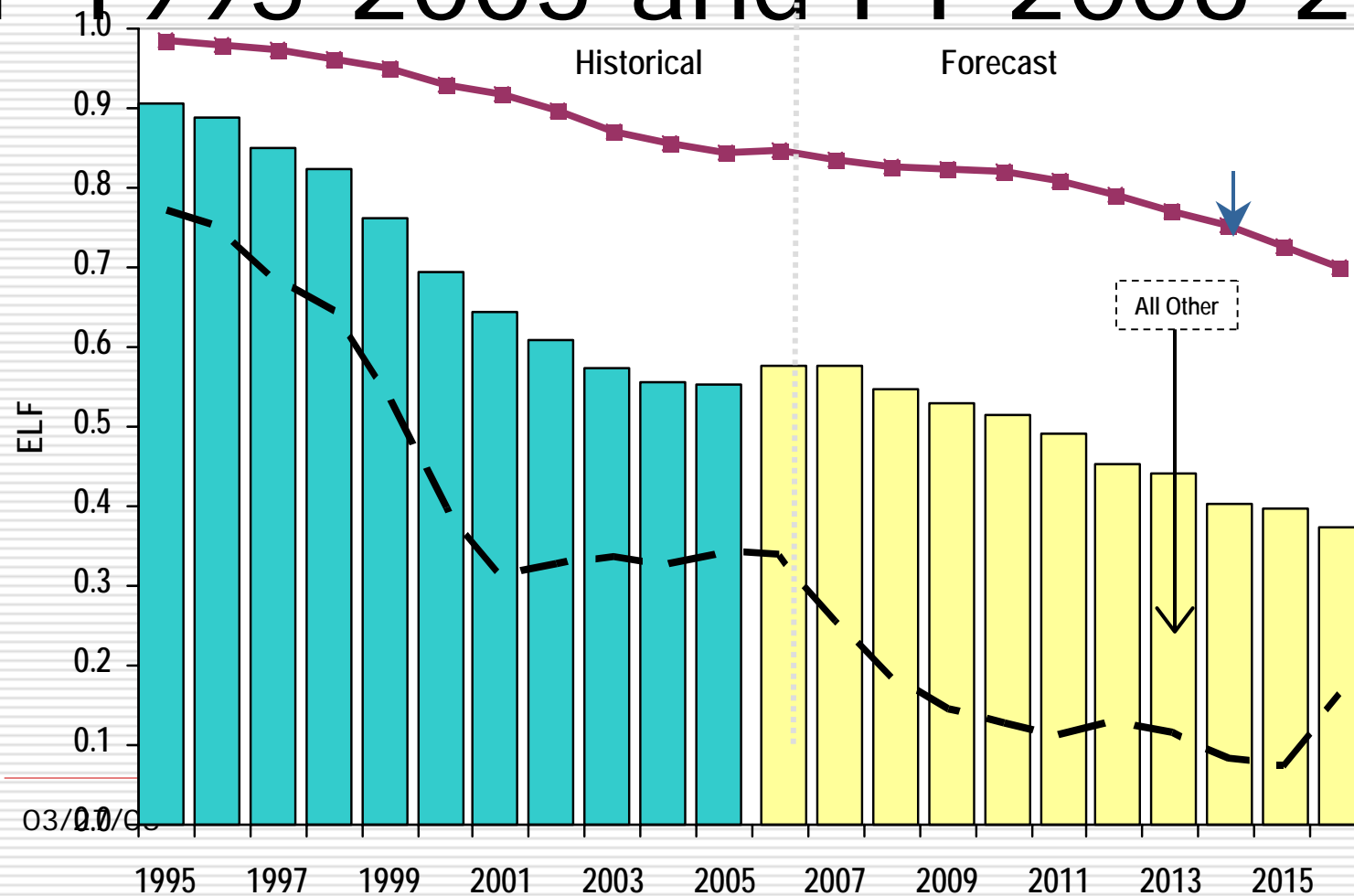
# Implicit Cost

	\$ in Billion
	\$11,238
Production Tax Net of Royalty	
<i>Less Implicit Cost from Proxy</i>	<u><i>(\$ 5,057)</i></u>
	\$ 6,181
Tax Rate	0.15
Proposed Production Tax	\$ 927

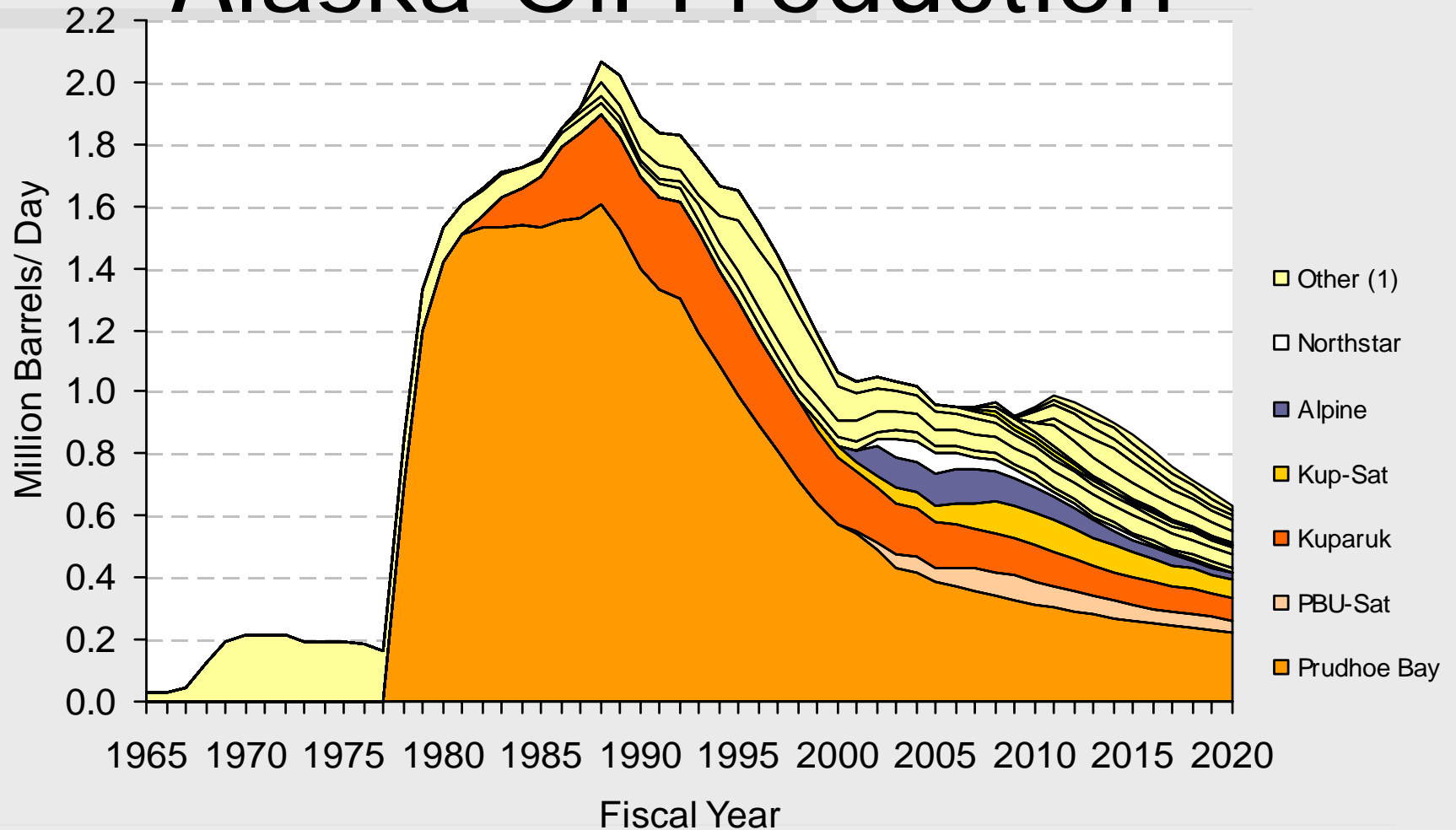
# Kuparuk Crude Oil Production & ELF



# Economic Limit Factor, FY 1995-2005 and FY 2006-2016



# Alaska Oil Production



Source: Fall 2005 Revenue Sources Book; Alaska Department of Revenue, Tax Division  
 03/27/06 (f) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and N-PRA.

# The Governor's 3 Big Ideas

---

- ❑ Idea Two: We need to use the Tax system to encourage investment
- ❑ Investment leads to more production
- ❑ More production leads to more revenue
- ❑ Four ways the bill recognizes investment

## 4 ways of encouraging investment

---

- ❑ Net vs gross – all investment is a deduction
- ❑ 20% credits for capital investments
- ❑ Up to a \$73 million Annual Allowance
- ❑ Recognition of Transition Investment Expenditures

# 4 ways of encouraging investment

---

- ❑ Net vs gross – all investment is a deduction  
*CS preserves*
- ❑ 20% credits for capital investments  
*CS preserves*
- ❑ Up to a \$73 million annual allowance  
*CS has a similar feature with up to 12 million dollar annual credit*
- ❑ Recognition of Transition Investment Expenditures  
*CS has reduced from 5 years to 3 months of investment*

# Tax Based on Net Profits

---

- Governor's bill provided a tax based on Net Profits
- CS maintains this approach

# Gross vs. Net

---

<b>Current Tax on Gross</b>		<b>PPT on Net</b>	
Value at wellhead	\$50.00	Value at wellhead	\$50.00
		Less:	
		Lease op exps	<u>(12.50)</u>
Times: tax rate	15%	Net taxable	\$37.50
		Times: tax rate	20%
Tax before ELF	\$7.50	Tax before credits	\$7.50

# Tax Base

---

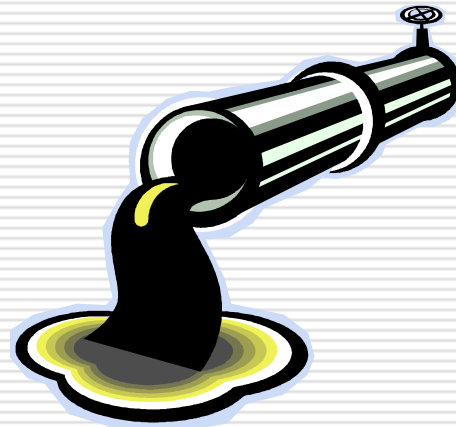
Gross value at point of production

# Determining value under current system

---

West coast value

\$



# Gross Value under PPT

---

Dept. of Revenue can allow a producer to elect the use of:

- Royalty value
- DOR formula that estimates a value at a specific location such as point of delivery into a common carrier pipeline

# Tax Based on Net Profits

---

Gross value at point of production

Less: Lease expenditures

- ♦ operating costs
- ♦ capital expenditures
- ♦ allowance for overhead

Equals: Net Profits

# Non-deductible expenses

---

- Depreciation
- Royalty payments
- Taxes based on net income
- Interest & financing charges
- Lease acquisition costs
- Other costs

# Governor's Bill: Credits to Encourage Investment

---

- **20%** of qualified capital expenditures
- May be taken on:
  - ◆ Exploration costs
  - ◆ Capital costs **incurred on lease**
- Credits are transferable

# CS: Credits to Encourage Investment

---

- CS maintains credits
  - CS also allows the State to purchase up to \$10M worth of credits
- Credits may not be taken on:
  - Abandonment costs

# Friendly to New Investors

---

- Ability to monetize credits and losses
- Base allowance
  - Governor's bill: \$73M deduction
  - CS: converts this to a credit of up to \$12M  
(equivalent to \$60M deduction)

# Effect of Standard Credit

---

	none	\$5M	\$12
net income	\$100.0	\$100.0	\$100.0
times:	20%	20%	20%
tax before credits	\$20.0	\$20.0	\$20.0
capex credit	0.0	(1.0)	(2.4)
standard credit	0.0	(5.0)	(12.0)
net due	\$20.0	\$14.0	\$5.6

# How are losses handled?

---

Gross value	\$50.00
less:	
Lease op exps	(12.50)
Capital exp's	<u>(60.00)</u>
Net loss (NOL)	(\$22.50)

# Net Operating Losses (NOL's)

---

- Can be converted to Credits
- 20% of loss

# Transition Provision

---

- Governor's bill allowed deductions for recent capital expenditures
  - Last five years' capital expenditures
  - Allowed over 5 years
  - Allowable on when price of oil exceeded \$40

# Transition Provisions in CS

---

- Allows cost recovery of assets placed in service 1/1/06—3/31/06
- Deduction of 1/9 of cost in each of 9 months after effective date

# The Governor's 3 Big Ideas

---

- ❑ Idea Three: We ought to get a fair share of tax revenues when prices are high, especially if reinvestment is low
- ❑ With high prices we are not getting a fair share
- ❑ We should be treated as fairly as other jurisdictions while remaining competitive with them for investment

# Fair Tax Rate

---

Governor's bill: 20%

# Fair Tax Rate

---

Governor's bill: 20%

*CS maintains general tax rate of 20% and adds progressive feature*

# Progressivity Surcharge

---

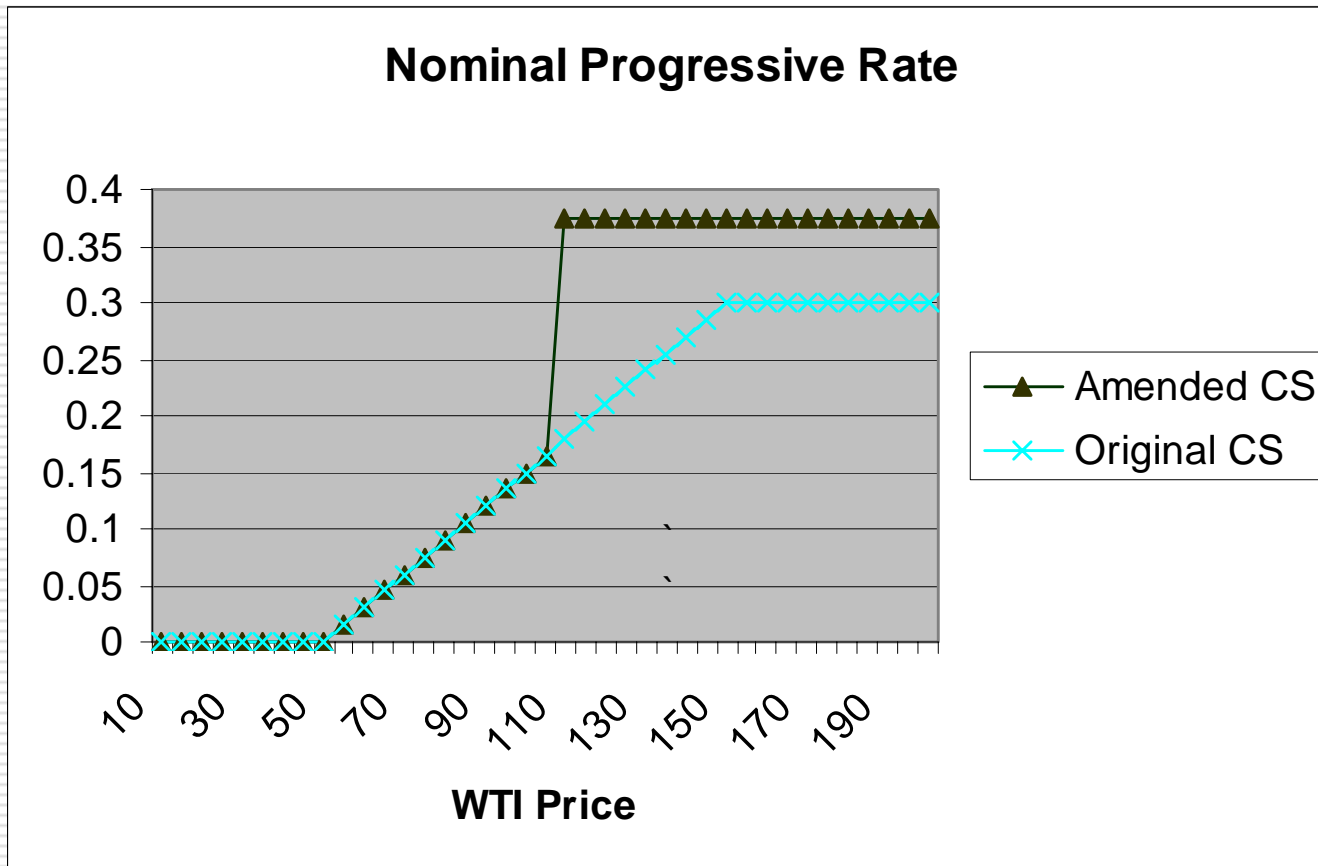
- Oil surcharge applies when oil price (WTI) exceeds \$50/bbl
- Gas surcharge applies when gas price (HH) exceeds \$8
- Deductible from PPT

# Progressivity Surcharge

---

- ❑ Oil surcharge adds 3% tax based on gross value of oil, for each \$10 increase in oil price
- ❑ Gas surcharge adds 2% tax based on gross value of gas, for each \$1 increase in HH gas price

# Progressivity Feature as Amended



## How does progressivity Feature Work?

	Governor's Bill
WTI Price:	\$ 70.00
ANS (Assume \$2 less)	68.00
Downstream Transportation	(7.00)
<i>Wellhead Value (gross)</i>	<i>61.00</i>
Upstream Production Costs	(7.00)
<i>Production Tax Value (net)</i>	<i>54.00</i>
	20%
	<b>10.80</b>
Percentage Gross	17.7%
Percentage Net	20.0%

## How Does Progressivity Feature Work?

	House Resources CS		
	PPT	Progressivity	Total
WTI Price:	\$ 70.00	\$ 70.00	
ANS (Assume \$2 less)	68.00	68.00	
Downstream Transportation	(7.00)	(7.00)	
<i>Wellhead Value (gross)</i>	<u>61.00</u>	<u>61.00</u>	61.00
Progressivity		<u>6%</u>	
Progressivity Amount	(3.66)	3.66	
Upstream Production Costs	<u>(7.00)</u>		
<i>Production Tax Value (net)</i>	<u>50.34</u>		54.00

# How Does Progressivity Feature Work? (Cont.)

House Resources CS  
~~PPT Progressivity Total~~

	PPT	Progressivity	Total
<i>Production Tax Value (net)</i>	50.34		54.00
PPT Rate	20%		
Total Tax	10.07	3.66	<b>13.73</b>
Percentage Gross	16.5%		22.5%
Percentage Net	20.0%		25.4%

# Governor's Bill: Other Provisions

---

- Monthly return filing
- 90% payment safe harbor
- Yearly true-up on 3/31

# Other Provisions in CS

---

spill fee remains the same in total

--suspended fee (AS 43.55.201)

--2 cents changed to 1 cent

--non-suspended fee (AS 43.55.300)

3 cents changed to 4 cents

No Longer Creditable as in Governor's Bill

# Other Provisions in CS

---

- ❑ SB 185 40% credits extended for 10 years
- ❑ Private royalty oil tax rate set at 5%
- ❑ Penalty applies if 90% safe-harbor not met
- ❑ Effective date changed from 7/1/06 to 4/1/06

# PPT: A Tax for Alaska's Future

---

