

Glossary of Terms Related to the Production Profit Tax

Capitalize.

1. In an accounting sense, the periodic expensing (amortization) of capital costs through depreciation or depletion.
 2. To convert an (anticipated) income stream to a present value by dividing by an interest rate, as in the dividend discount model.
 3. To record capital outlays as additions to asset value rather than as expense.
- Generally, expenditures that will yield benefits to future operations beyond the accounting period in which they are incurred are capitalized—that is, they are depreciated at either a statutory rate or a rate consistent with the useful life of the asset.

Cash Flow

1. Net income plus depreciation, depletion, and amortization and other non-cash expenses. Usually synonymous with cash earnings and operating cash flow.
2. An analysis of all the changes that affect the cash account during an accounting period.

Dollars-of-the Day

A term usually associated with cost estimates that indicate the effects of anticipated inflation have been taken into account. For example, if a well costs \$5 million right now in “today’s dollars” (the opposite of dollars-of-the day), then the cost of the well two years from now might be estimated at \$5.51 million in dollars-of-the-day assuming a 5% inflation factor. Also called *escalated dollars*.

Dutch Disease

The adverse results of large-scale positive shock to a single sector of a nation’s economy, so named because of the problems associated with large-scale development of the Groningen Gas field in the Netherlands in the 1970s. Typically the sector of economy that is booming causes widespread inflation and other sectors, particularly agriculture, suffer from inability to attract workers. The drastic increase in foreign exchange can cause problems with local currencies and fiscal and monetary problems can occur without proper management.

Equity Oil

Usually this term refers to oil or revenues after cost recovery (or cost oil). It is also referred to as profit oil or share oil—terms that are most often associated with PSCs. Generally speaking, the analog to equity oil in a concessionary system would be pretax cash flow. Like pretax cash flow, equity oil may also be subject to taxation.

Expense

1. In a financial sense, a non-capital cost associated most often with operations or production.
2. In accounting, costs incurred in a given accounting period as expenses and charged against revenues. To expense a particular cost is to charge it against income during the accounting period in which it was spent. The opposite would be to capitalize the cost and charge it off through some depreciation schedule.

Exploratory Well

A well drilled in an unproved area. This can include: (1) a well in proved area seeking a new reservoir in a significantly deeper horizon, (2) a well drilled substantially beyond the limits of existing production. Exploratory wells are defined partly by distance from proved production and by degree of risk associated with the drilling. Wildcat wells involve a higher degree of risk than exploratory wells.

Fiscal System

Technically, the legislated taxation structure for a country including royalty payments. In popular language, the term includes all aspects of contractual and fiscal elements that make up a given government-foreign oil company relationship.

Government Take

The total government share of profit oil or revenues not associated with cost recovery. Same as government after-tax equity split and government marginal take.

Heavy Oil

A type of crude oil which is very viscous and does not flow easily. There is no one definition, and may be characterized as having an American Petroleum Institute [API] gravity less than 20°. The common characteristics properties are the following:

- High specific gravity
- Low hydrogen to carbon ratios
- High carbon residues and
- High contents of asphaltenes, heavy metal, sulphur and nitrogen

Incentives

Fiscal or contractual elements emplaced by host government that make petroleum exploration or development more economically attractive includes such things as:

- Royalty Holidays
- Tax holidays
- Tax credits
- Reduced government participation
- Lower government take
- Investment credits/uplifts
- Accelerated depreciation

Intangible Drilling and Development Costs (IDCs)

Expenditures for wages, transportation, fuel, fungible supplies used in drilling and equipping wells for production.

Intangibles

All intangible assets such as goodwill, patents, trademarks, unamortized debts discounts, and deferred charges.

Investment Credit

A fiscal incentive where the government allows a company to recover an additional percentage of tangible capital expenditure. For example, if a contractor spent \$10 million on expenditures eligible for a 20% investment credit, than the contractor would actually be able to recover \$12 million through cost recovery (see Uplift). These incentives can be taxable. Sometime the investment credit is mistakenly referred to as an investment tax credit.

Netback

Many royalty calculations are based upon gross revenues from some point of valuation, usually the last value off of a production platform or at the boundary of a field or license area. The point of sale, however, may be different than the point of valuation. The statutory royalty calculation may allow the transportation costs from the point of valuation to the point of sale to be deducted. This is called *netback formula*.

Operating Profit (or Loss)

The difference between business revenues and the associated costs and expenses exclusive of interest or other financing expenses, and extraordinary items, or ancillary activities. Synonymous with net operating profit (or loss), operating income (or loss), and net operating income (or loss).

Production Sharing Agreement

This (PSA) is the same as a Production Sharing Contract (PSC). While at one time this term was quite common, it is use less frequently now, and the term *Production Sharing Contract* is becoming more common.

Production Sharing Contract

A contractual agreement between a contractor and a host government whereby the contractor bears all exploration costs and risks and development and production costs in return for a stipulated share of the production resulting from this effort.

Progressive Taxation

Where tax rates increase as the basis to which the applied tax increases. Or where tax rates decrease as the basis decreases. The opposite of regressive taxation.

Severance Tax

A tax on the removal of minerals or petroleum from the ground, usually levied as a percentage of the gross value of the minerals removed. The tax can also be levied on the basis of so many cents per barrel or per million cubic feet of gas.

Tax

A compulsory payment pursuant to the authority of a government. Fines, penalties, interest, and customs duties are not taxes.

Working Interest

The percentage of interest ownership a company (or government) has in joint venture, partnership, or consortium. The expense-bearing interest of various working-interest owners during exploration, development, and production operations may change at certain stages of a contract or license. For example, a partner with a 20% working interest in a concession may be required to pay 30% of exploration costs but only a 20% share of development costs. With government participation, the host government usually pays no exploration expenses but pays prorated development and operating costs and expenses.