

Navigating CSSB 305 (RES) (With the Differences from SB 305 Highlighted)

Before the Senate Finance
Committee

April 1, 2006

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SB 305, Section 35
CSSB 305, Section 32

**New production tax provisions apply to oil
and gas produced on or after:**

July 1, 2006 (SB 305)

April 1, 2006 (CSSB 305)

SB 305, Section 5

AS 43.55.011(a)

There is levied upon the producer . . . a tax for all **oil and gas** produced **each month** . . . The tax is equal to **20 percent** of the **net value** . . . under AS 43.55.160.

CSSB 305, Section 5

AS 43.55.011(e)

There is levied upon the producer . . . a tax for all **oil and gas** produced **each month** . . . [except for] a lessor's royalty interest. . . .

The tax is equal to **25 percent** of the **production tax value** . . . under AS 43.55.160.

CSSB 305, Section 5 (cont.)

AS 43.55.011(f)

There is levied upon the producer . . . a tax for all oil and gas produced each month . . . the ownership or right to which constitutes a **lessor's royalty interest** The tax is equal to **five percent of the gross value at the point of production** [for existing leases]

- BUT . . .

CSSB 305, Section 6 (cont.)

AS 43.55.011(f) (cont.)

The tax is equal to 1.5 percent of the gross value at the point of production [for existing *COOK INLET BASIN* leases]

- AND . . .

CSSB 305, Section 6 (cont.)

AS 43.55.011(f) (cont.)

The commissioner shall **recommend to the legislature** the rate of tax **[for FUTURE leases]**

CSSB 305, Section 6 (cont.)

AS 43.55.011(g) – (h)

[When West Coast ANS is **above \$40/Bbl**]
there is levied upon the producer of **oil** a tax
... equal to

$$\begin{aligned} & (\text{West Coast ANS} - 40) * .2\% * \\ & (\text{ANS Prevailing Value}) * 75\% * \\ & (\text{amount of oil production}) \end{aligned}$$

So . . .

The **original bill** has a **single** production tax: 20 % of net value.

The **CS** has **three** production tax components:

- (1) 25% of net value (now called “production tax value”) *except* for lessor royalty share
- (2) 5% or 1.5% of gross value for lessor royalty share
- (3) A progressive-rate tax on prevailing value of *oil* only, including lessor royalty share

SB 305, Section 21

AS 43.55.160(a)

net value . . . is the total of the **gross value at the point of production** of . . . oil and gas . . . from **all leases or properties** in the state, less . . . **lease expenditures** . . . as **adjusted** . . . and . . . 1/72 of . . . **transitional investment expenditures**.

CSSB 305, Section 22

AS 43.55.160(a)

production tax value . . . is the total of the
gross value at the point of production of . . .
oil and gas . . . from **all leases or properties** in
the state,
less **lease expenditures** . . . as **adjusted**

SB 305, Section 31 CSSB 305, Section 28

AS 43.55.900(7)

“gross value at the point of production”
means

for **oil**, the value . . . at the . . . meter . . . in .
. . . **pipeline quality**

for **gas** . . . the value . . . where . . . metered
[**after any separation or gas processing**]

SB 305, Section 19
CSSB 305, Section 20

AS 43.55.150(a)

... gross value at the point of production is
calculated using the reasonable **costs of
transportation** ...

SB 305, Section 20

AS 43.55.150(d)

... the department **may allow** ... gross value
[to be calculated based upon] ... a **royalty
settlement agreement** ... [or]
a formula ... that uses ... [**DNR or U.S.
Dep't of Interior**] royalty ... valuation [or]
another **formula** ... **that reasonably
estimates** a value

CSSB 305, Section 21

AS 43.55.150(d)

if the commissioner completes a detailed fiscal analysis and determines . . . the long-term fiscal interests of the state [would be served] . . . the department **may allow** . . . gross value [to be calculated based upon **DNR or U.S. Dep't of Interior**] royalty . . . valuation [or] another **formula . . . that reasonably estimates** a value

SB 305, Section 21

AS 43.55.160(c)

... lease expenditures ... are the **total** costs **upstream** of the point of production ... on or after **July 1, 2006** ... that are the **direct, ordinary, and necessary** costs of **exploring for, developing, or producing** oil or gas ... in the state.

CSSB 305, Section 22

AS 43.55.160(c)

... lease expenditures ... are the **total** costs **upstream** of the point of production ... on or after **April 1, 2006** ... that are the **direct, ordinary, and necessary** costs of **exploring for, developing, or producing** oil or gas ... in the state.

Section 21/22

AS 43.55.160(c) (continued)

In determining . . . [**direct, ordinary, and necessary**] costs . . . the department shall give substantial weight . . . to typical **industry practices and standards** . . . as to [billable] costs . . . under **unit operating agreements** . . . and [**DNR net profits share lease regulations**].

CSSB 305, Section 22

AS 43.55.160(n)(2)

CS adds a definition of “**ordinary and necessary**” to make clear that **Internal Revenue Code** meaning is adopted.

Section 21/22

AS 43.55.160(d) provides specific examples of, and exclusions from, “direct costs”

CSSB 305 has several improvements recommended by the Administration: e.g.,

- (d)(1)(A) and (d)(2)(A), clarifying treatment of capitalized expenditures
- (d)(2)(L), ensuring that conservation surcharges are not deductible

CSSB 305, Section 22 (cont.)

CSSB 305 has several additional exclusions:

- (d)(2)(M) Costs of dismantlement, removal, restoration, etc., re: previous oil or gas production
- (d)(2)(N) Costs above fair market value, in non-arm's length transactions
- (d)(2)(O) Costs to acquire a company

SB 305, Section 21

AS 43.55.160(e)

[Lease expenditures must be **adjusted** by **subtracting payments** the producer **receives** for (1) another's use of a production facility; (2) reimbursement, e.g. field costs paid by state, that offset lease expenditures; and (3) sale of assets acquired through lease expenditures or of non-taxable oil or gas used in lease operations.]

CSSB 305, Section 22

AS 43.55.160(e)

[Lease expenditures must be **adjusted** by **subtracting payments** the producer **receives** for (1) another's use of – **or for managing** -- a production facility; (2) reimbursement, e.g. field costs paid by state, that offset lease expenditures; and (3) sale – **or removal from the state** – of assets acquired through lease expenditures or of non-taxable oil or gas used in lease operations.]

CSSB 305, Section 22

AS 43.55.160(a), (b)(2), and (e)

At the Administration's recommendation, the CS addresses potential timing mismatches between lease expenditures and adjustments, ensuring that the tax effect of an adjustment will be recognized even if a producer or explorer has no production, or has low lease expenditures, when an adjustment payment is received.

CSSB 305, Section 22

AS 43.55.160(k) and (l)

For purposes of (1) excluding from lease expenditures costs that exceed fair market value, and (2) determining the amount of an adjustment to lease expenditures due to the sale of an asset, **standard = “a producer dealing at arm’s length with an uncontrolled entity”**; and **IRS rules may be adopted.**

SB 305, Section 21

AS 43.55.160(g)

... transitional investment expenditures are ...
capital expenditures [incurred **7/2001 through 6/2006**] ... less ... [proceeds from] the **sale ... of assets** ... acquired ... as a result of [those] capital expenditures

[This provision is **not in the CS**; instead CS provides for a **tax credit for some transitional investment expenditures.**]

SB 305, Section 21

AS 43.55.160(i)

... a producer that is **qualified** ... may reduce the net value by **deducting an allowance** ... [T]he total of the allowances ... during the calendar year does **not exceed \$73,000,000**. An unused allowance ... may **not be carried forward**

[This provision is **not in the CS**; instead CS provides for **an allowance** that depends on the **average daily oil and gas production**.]

CSSB 305, Section 22

AS 43.55.160(g)

... a producer that is **qualified** ... and **produces under 55,000 BOE/day** may reduce the net value by **deducting an allowance** ... equal to the following fraction of the production tax value:

$$(5,000 - 0.2 * [\text{average daily production} - 5,000]) \div \text{average daily production}$$

CSSB 305, Section 22

AS 43.55.160(h) – producer's **qualification** for an allowance - **ability to qualify expires in 2013**

This is an anti-splitting provision to prevent abuse of the *per producer* allowance under AS 43.55.160(g).

It is essentially the same anti-splitting provision that is in sec. 21 of the original bill, for the \$73 million *per producer* allowance.

SB 305, Section 7

CSSB 305, Section 7

AS 43.55.020(a)

... the tax levied under AS 43.55.011, **net of any credits** applied under this chapter, is due

... the tax levied under **AS 43.55.011(e)** . . . **net of any credits** applied under this chapter, is due

SB 305, Section 12
CSSB 305, Section 13

AS 43.55.024(a)

... a producer ... that incurs a **qualified capital expenditure** ... may ... elect ... to take a **tax credit** in the amount of **20 percent** of that expenditure.

Section 12/13 (cont.)

AS 43.55.024(h)(1) and (j)(2)

[AS 43.55.024(h)(2) in original bill]

“qualified capital expenditure” -

- [is a **lease expenditure** for G&G exploration, intangible drilling costs, and other expenditures **capitalized** under IRC]
- [does **not** include purchase of a previously acquired or used asset]

CSSB 305, Section 13 (cont.)

AS 43.55.024(h)(2)

“qualified capital expenditure” does **not** include

an expenditure incurred . . . **for . . . an extended period of disuse, dismantlement, removal . . . or abandonment . . . or for the restoration of a lease, field, [etc.]**

HB 305 Section 12 (cont.)

AS 43.55.024(b)

A producer may elect to take a **tax credit** . . . of **20 percent** of a carried-forward **annual loss** [which is the amount of a previous year's **lease expenditures** that were **not deductible** because they would have reduced the net value of the oil and gas below zero].

CSHB 305 Section 13 (cont.)

AS 43.55.024(b)

A producer . . . may elect to take a **tax credit** . . . of **25 percent** of a carried-forward **annual loss** [which is the amount of a previous year's **lease expenditures** that were **not deductible** because they would have reduced the **production tax value** of the oil and gas below zero].

Section 12/13 (cont.)

AS 43.55.024(d) – (f)

A producer entitled to a tax credit may apply to the Dep't of Revenue for a **transferable tax credit certificate**. Once issued, a certificate may be used for its face value, but a transferee may not apply a certificate to reduce its tax liability by more than **20 percent** during a calendar year.

CSSB 305, Section 13 (cont.)

AS 43.55.024(i) – **nontransferable credit for transitional investment expenditures**

... transitional investment expenditures [TIE] are
... **capital expenditures** [incurred **4/2001 through 4/2006**] ... less ... [proceeds from] the **sale ... of assets** ... acquired ... as a result of [those] capital expenditures

CSSB 305, Section 13 (cont.)

AS 43.55.024(i) (cont.)

- a producer may . . . take a **tax credit . . . of 20 percent** of the producer's [**TIE**] but only [up to] **one-half of the producer's qualified capital expenditures . . . during the month**
- credits are **non-transferable**
- credit provision **expires April 1, 2013**

SB 305, Sections 22-29

CSSB 305, Sections 23-26

Original bill allowed a **credit** to be taken for conservation surcharge payments; CS does **not**.

CS **reduces** sec. 201 surcharge from \$.02 to \$.01 per barrel and **increases** sec. 300 surcharge from \$.03 to \$.05 per barrel.

SB 305, Section 7

Ninety percent of production tax, net of credits, is due **each month**.

The remainder is due **March 31** of the next calendar year.

CSSB 305, Sections 7, 12

AS 43.55.020(e) and (f)

- **95 percent** of principal production tax (AS 43.55.011(e)), net of credits, due **each month**. Remaining portion due at end of **next calendar quarter**.
- **100 percent** of tax on lessor royalty interest (AS 43.55.011(f)) due each month.
- Bill does not specify payment of progressive-rate oil tax (AS 43.55.011(g)).

SB 305, Section 9

CSSB 305, Section 9

[P]roducer may deduct [from royalty] the amount of the tax paid on taxable royalty oil and gas . . .

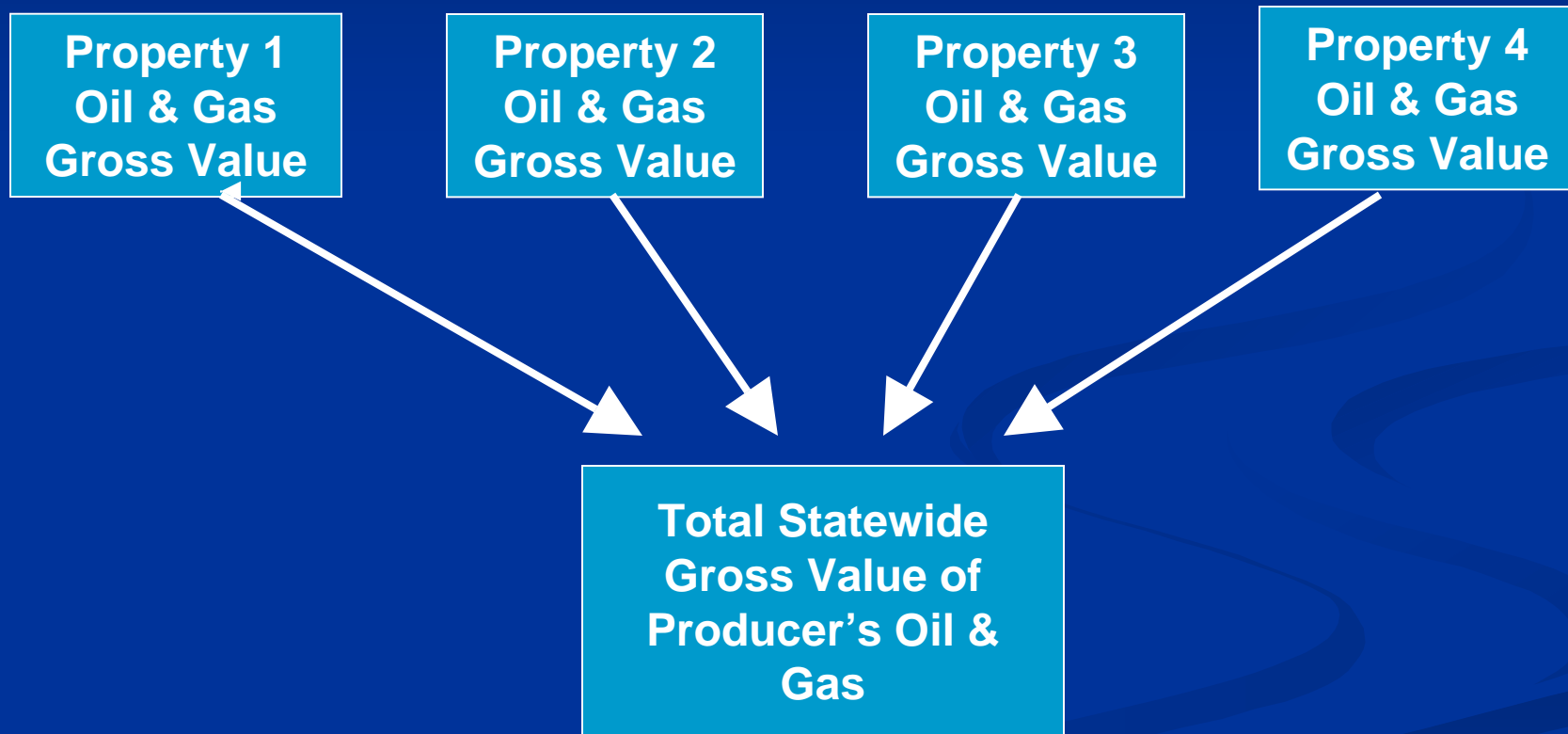
- Original bill provides a default formula for allocating the 20% tax on net value to royalty share.
- CS provides a slightly different formula for allocating the 25% tax on net value (“production tax value”) to *non-lessor* royalty share.

STEPS IN TAX CALCULATION

Under CSSB 305 (RES)

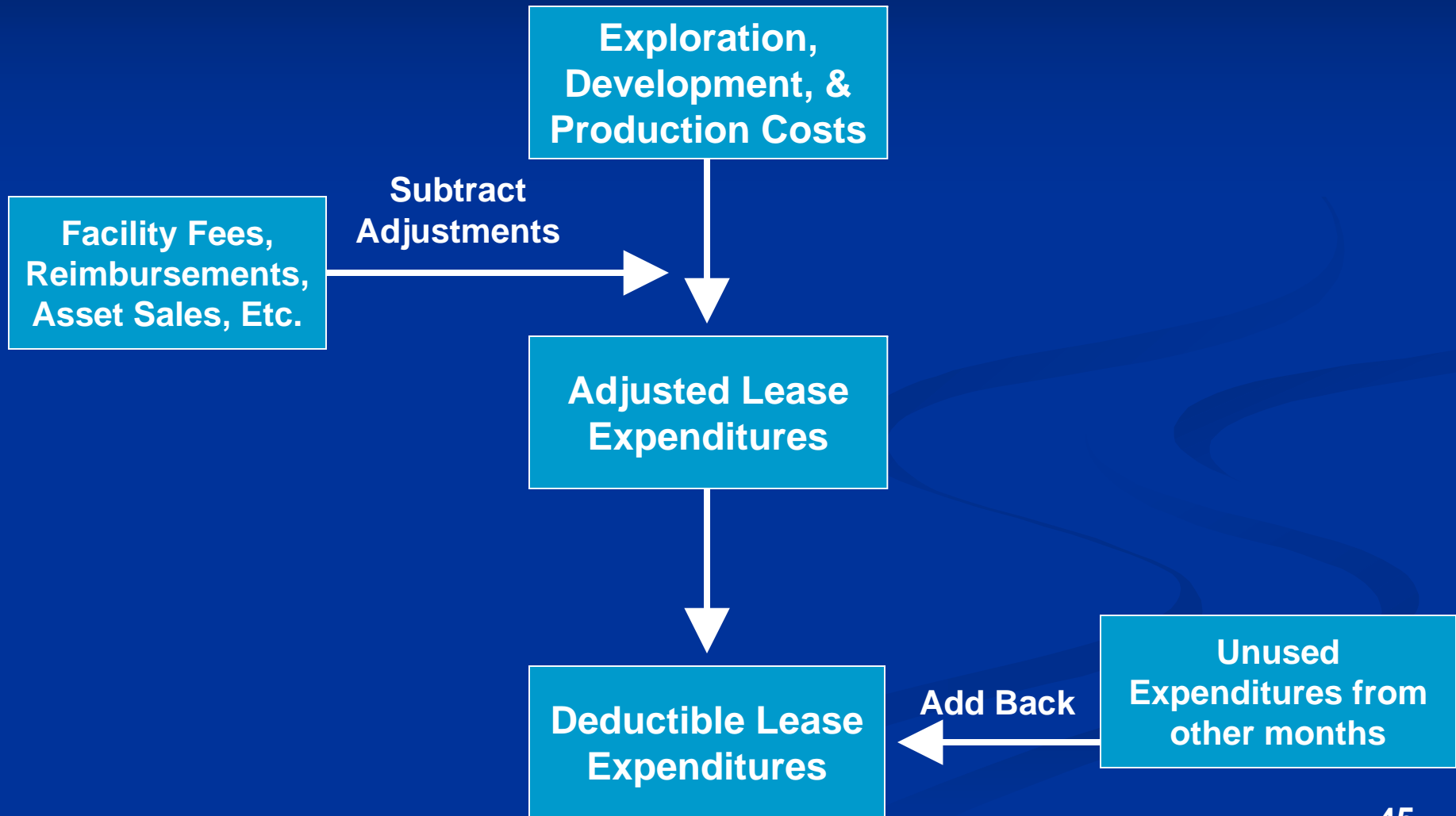
GROSS VALUE OF OIL AND GAS

AS 43.55.150, AS 43.55.900



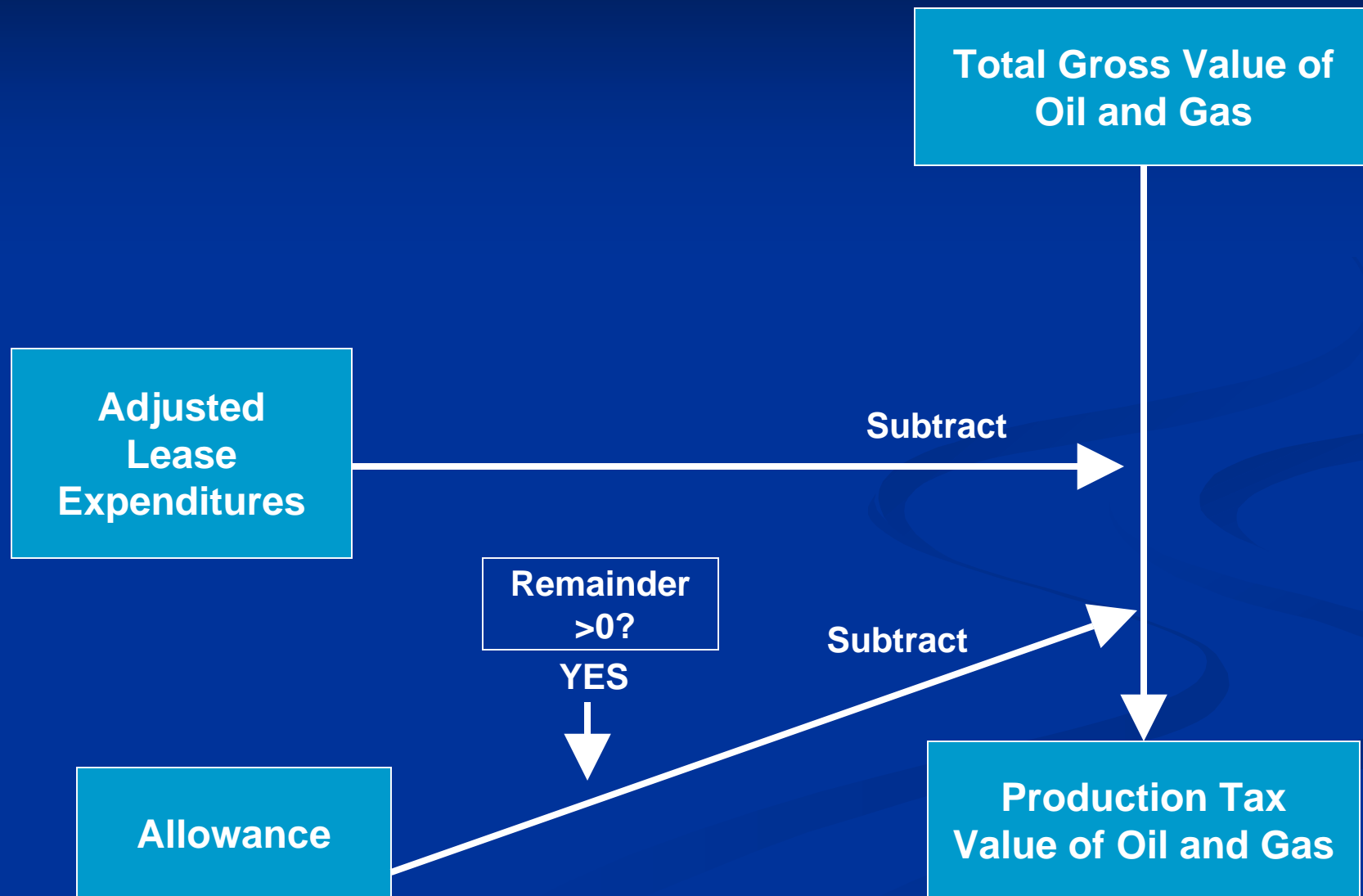
LEASE EXPENDITURES

AS 43.55.160(b) – (e)



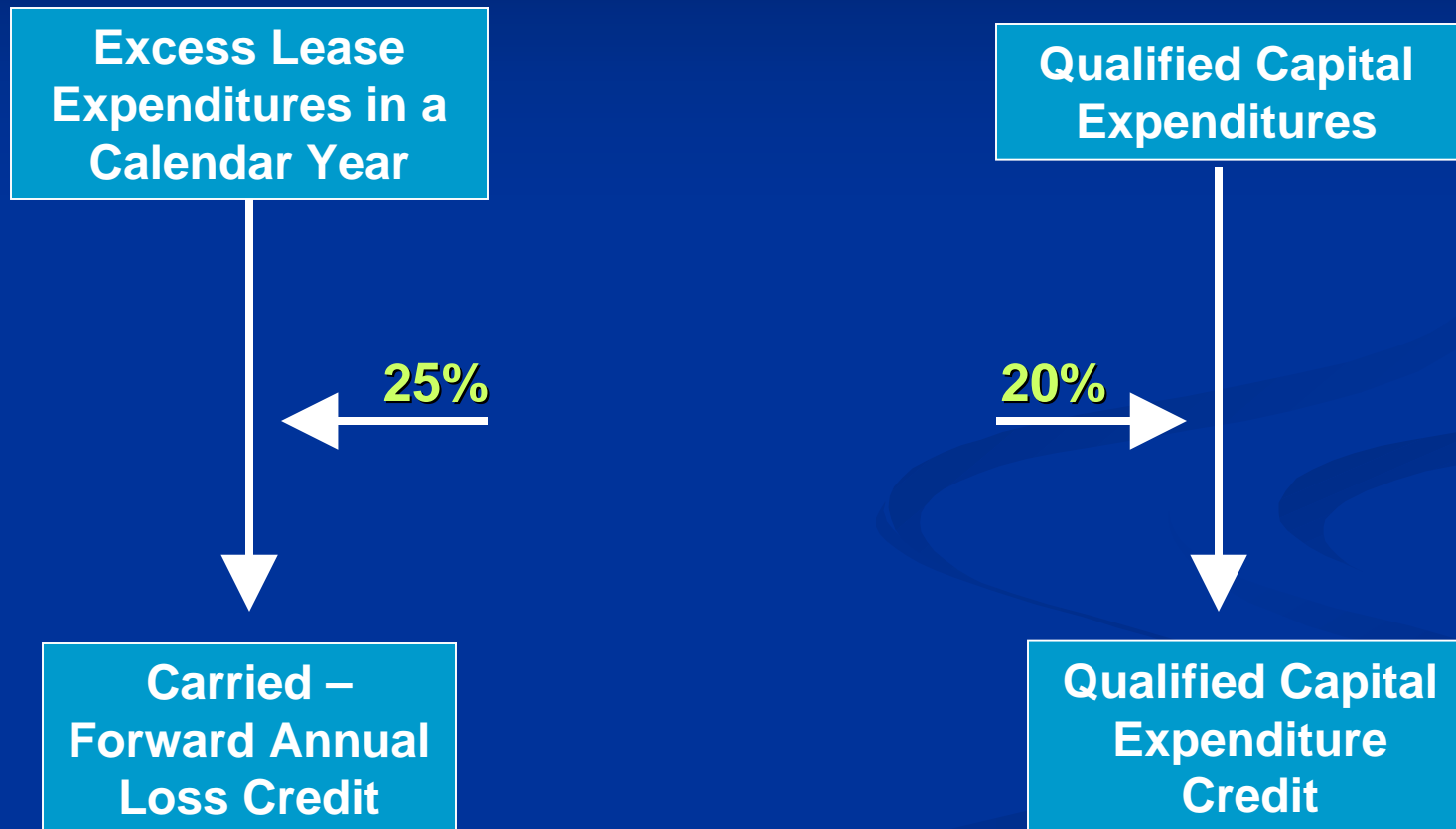
PRODUCTION TAX VALUE

AS 43.55.160 (a) and (g)

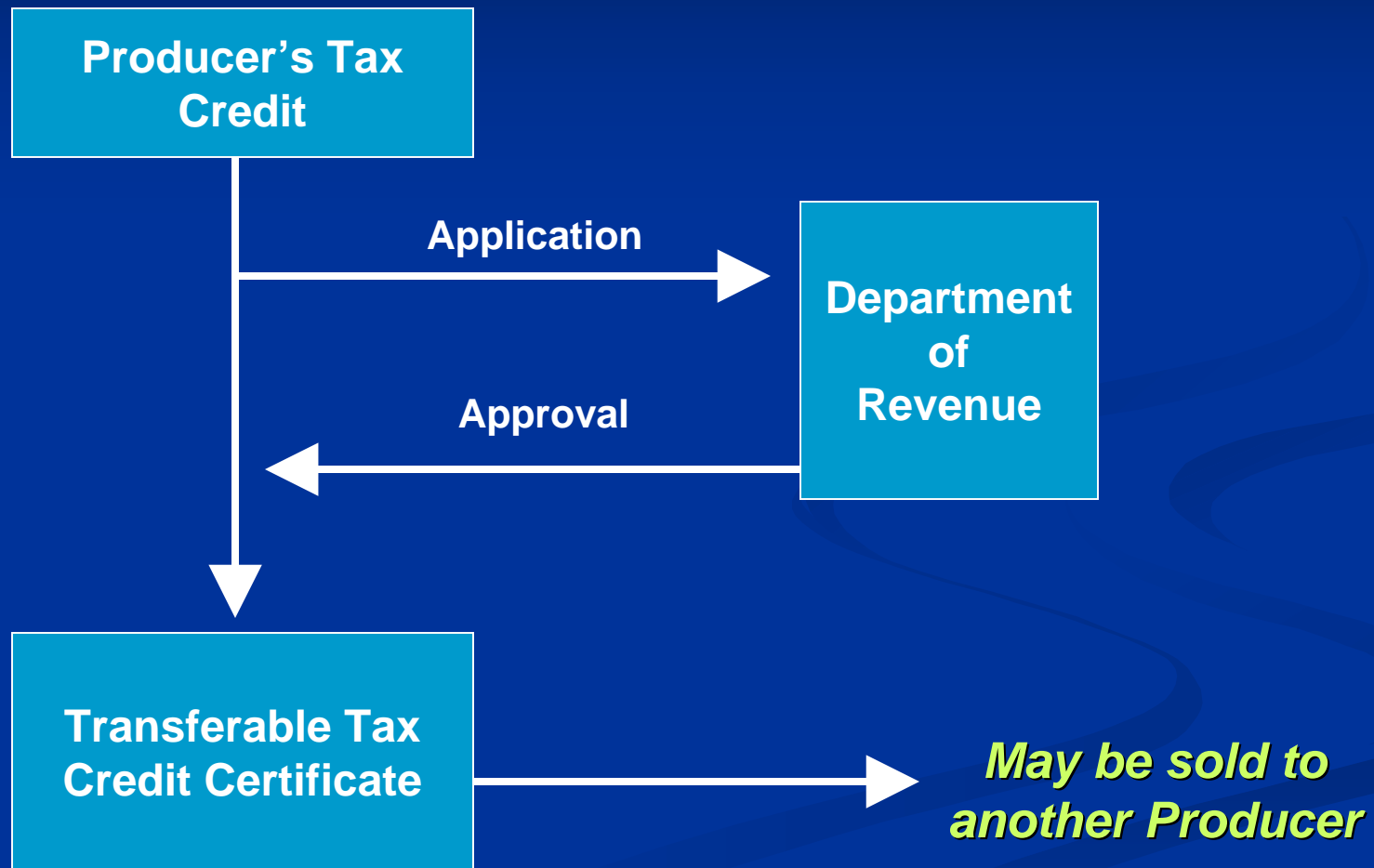


SEC. 024 TRANSFERABLE TAX CREDITS

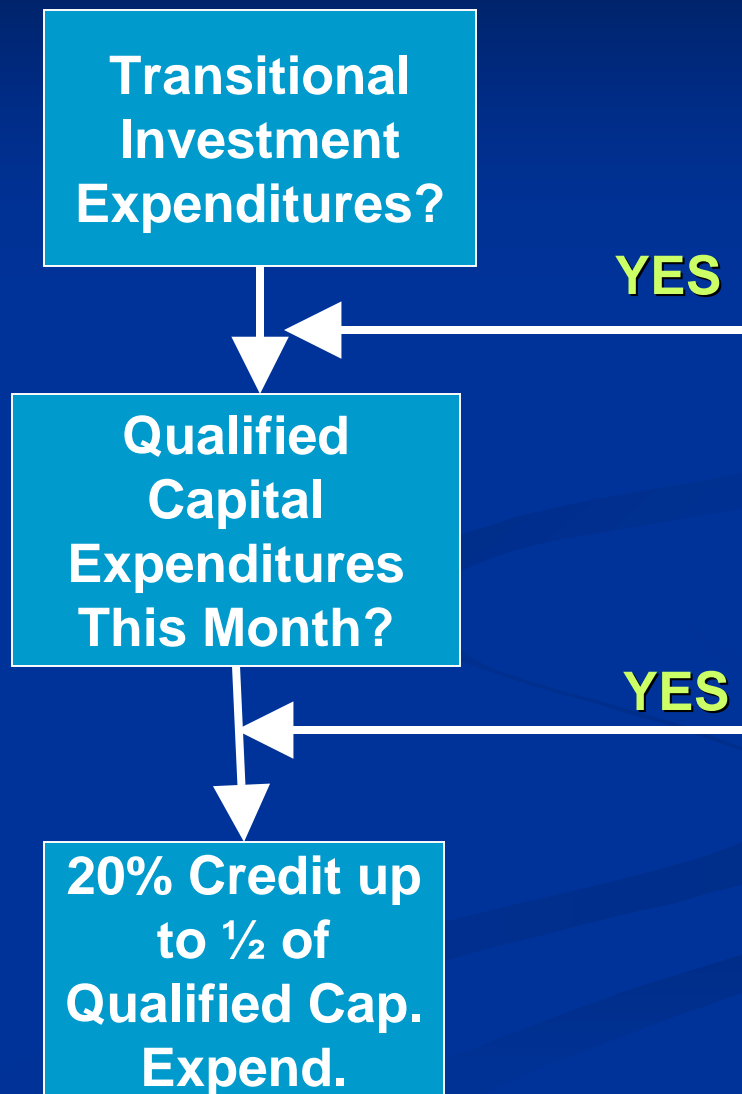
AS 43.55.024 (a) and (b)



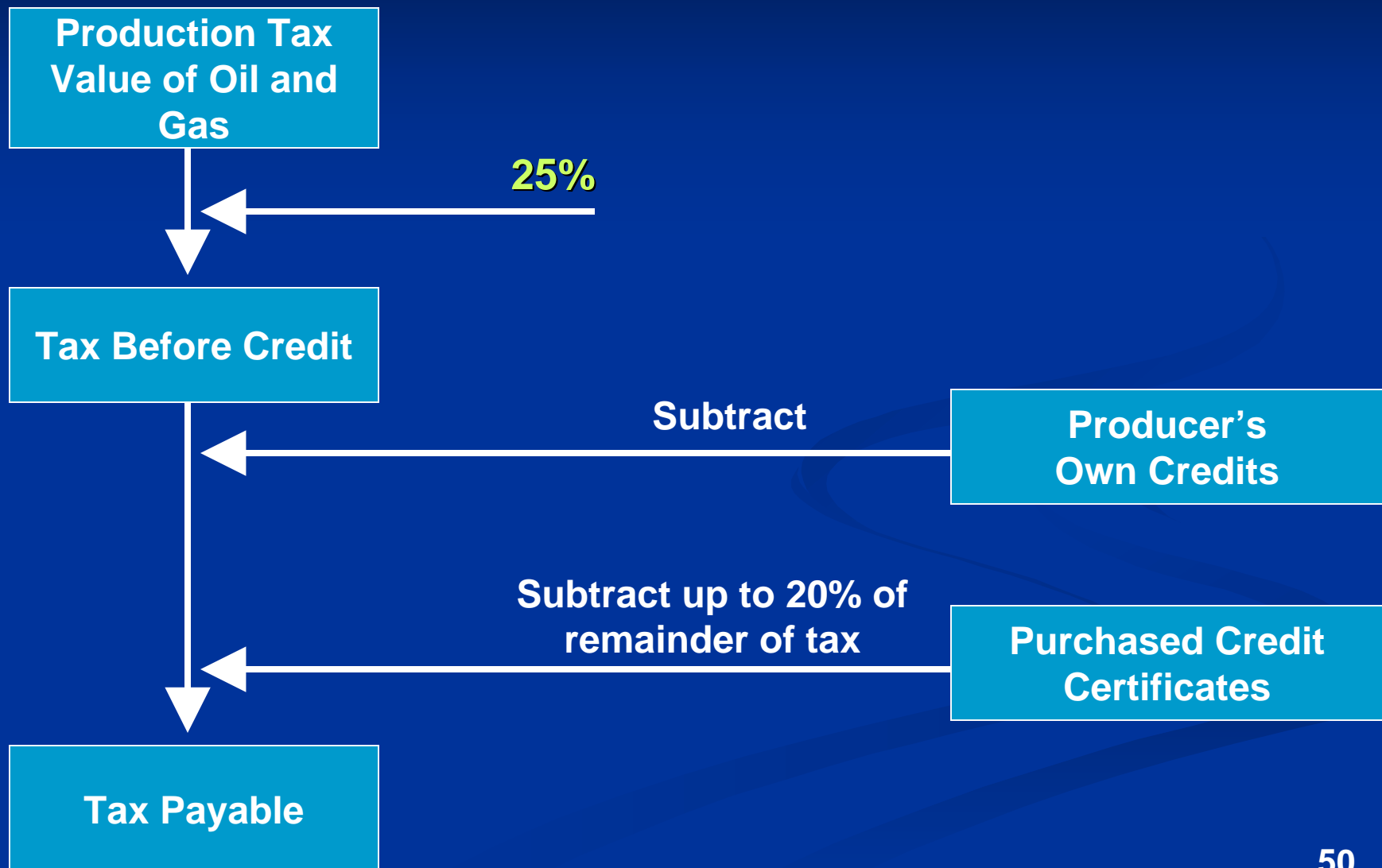
TRANSFERABLE TAX CREDIT CERTIFICATES - AS 43.55.024 (d)-(f)



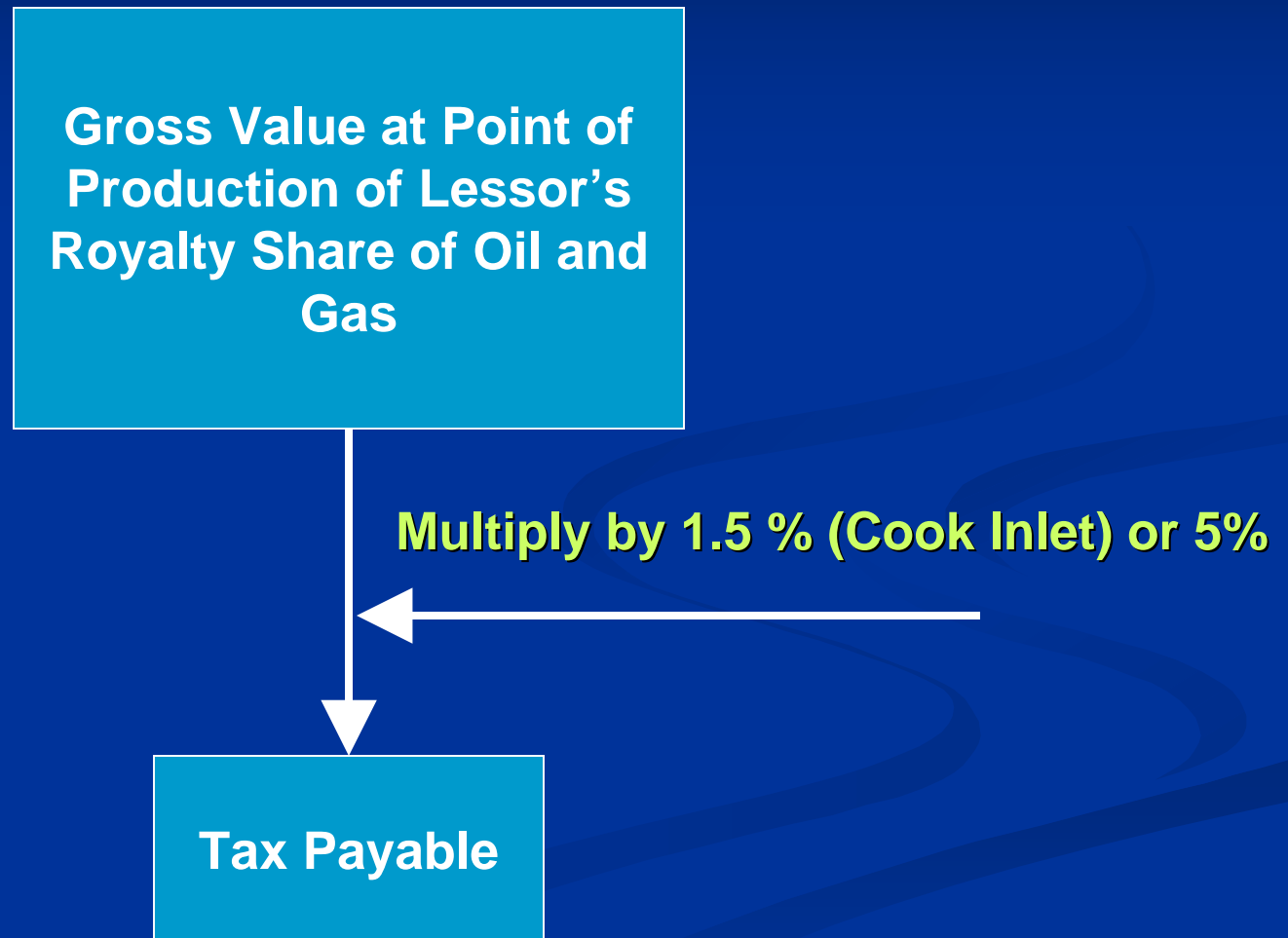
TIE CREDIT 43.55.024(i)



TAX CALCULATION: AS 43.55.011(e), 43.55.024

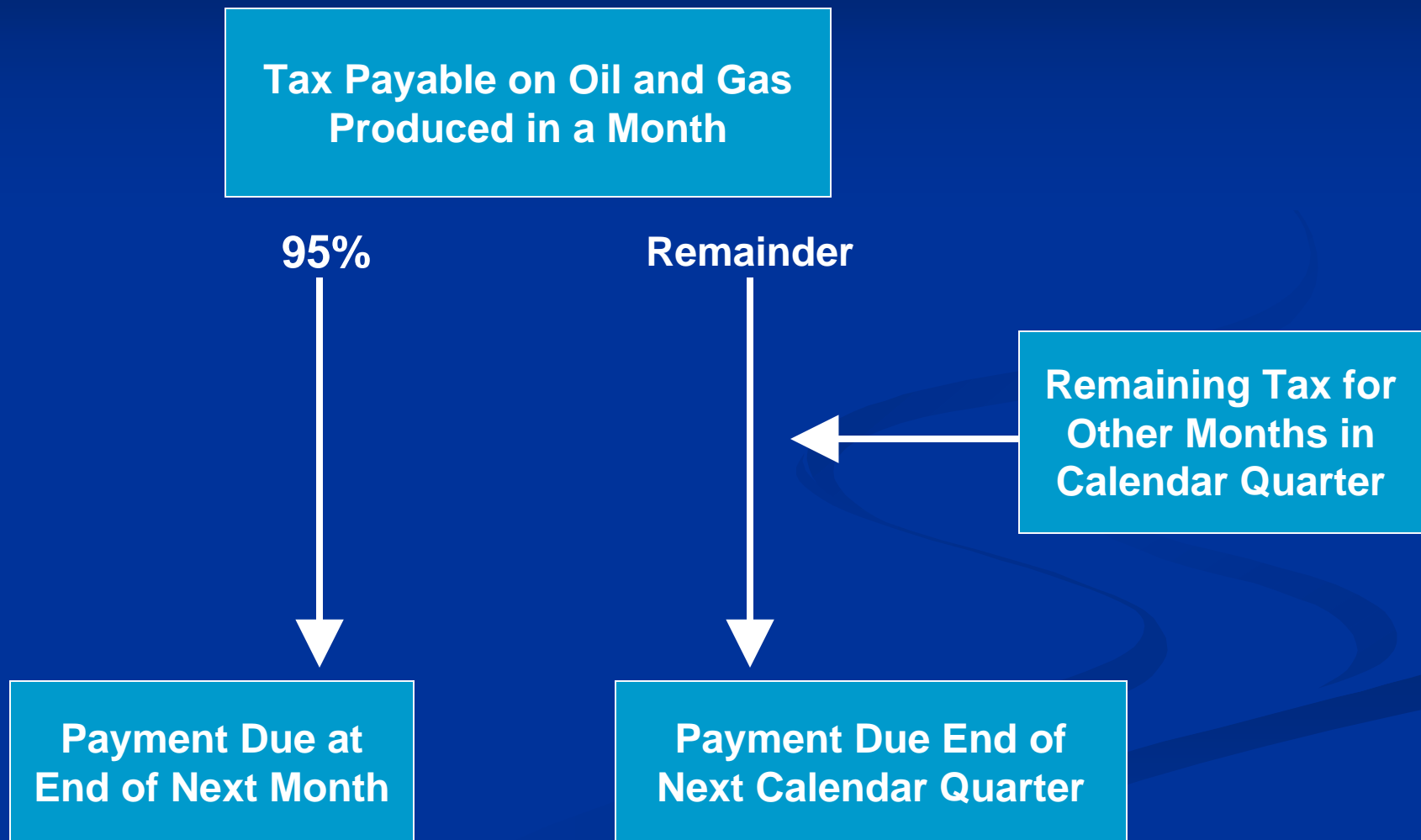


TAX CALCULATION: AS 43.55.011(f)



TAX PAYMENT

AS 43.55.020(e)



TAX PAYMENT AS 43.55.020(f)

Tax Payable on Oil and Gas
Produced in a Month

100%



Total Due at End of
Next Month