South Central Alaska Energy Forum

Taxes and Incentives

September 20, 2006

Mark Edwards
Revenue Development
Department of Revenue

Benefits of new PPT Legislation

- New cash flow benefits to explorers and investors
- Low to zero production tax at low energy prices
- Enhanced risk sharing by the state
- Increased incentives for oil with high production costs, such as heavy oil
- Protected Cook Inlet production with an ELF ceiling
- Improved benefits to new investors

Benefits of new PPT Legislation

- Added new area development credits of $6 million
- Extended the duration of existing oil and gas exploration tax credits
- Created more incentives for reinvestment in Alaska
- Provided options for tradable or reimbursable tax credits
- Established small producer tax credits of up to $12 million

Benefits of Net over Gross

- PPT has comparable incentives found in ELF for diminishing profitability in declining fields
- Can deduct qualified capital and operating expenses from revenues
- As costs go up relative to profits, the net tax paid will be less
- Creates more incentives for reinvestment in Alaska
- Significantly benefits high cost heavy oil production
- Adjusts easily to changing economic circumstances

Cash Flow Benefits

- Back end loaded production tax, time value of $
- Tax payments lower during initial capital outlays, higher as production responds to investment
- The NPV of a project improves when credits are monetized and deductions are taken early on

Risk Sharing by the State

- By allowing you to deduct your exploration costs expenses for unsuccessful wells are written off against profits from successful finds

- The State is in effect sharing risk in dry holes

Benefits to New Investors

- Dry hole costs can be reduced through credits
- Monetize losses by selling your loss carry-forward and credits for capital expenditures
- State qualified cash refunds up to a certain limit

PPT creates four distinct areas 43.55.160

- North Slope oil & gas – north of 68° north latitude
- Cook Inlet oil – oil in the C.I. sedimentary basin
- Cook Inlet gas – gas in the C.I. sedimentary basin
- Rest of the state – oil and gas not in N.S. or C.I.

ELF ceiling for Cook Inlet 43.55.011 (j) – (k)

- Previously producing leases fix a ceiling based on ELF from March 31, 2005 to March 31, 2006
- New leases after March 31, 2006 pay no more than ELF average for all previous leases
- Taxes will never be higher than ELF baseline
- Certainty on maximum payment
- PPT rate may even be lower than ELF at times
- Ceiling is fixed through 2021

New Area Development Credit 43.55.024 (a) – (b)

- Qualified producers outside Cook Inlet and North Slope can apply for a tax credit of up to $6 million against their production tax
- Profitable production in new areas of Alaska, such as the Alaska Peninsula, Nenana Basin will qualify
- This incentive is effective until 2016

Small Producer Tax Credit
43.55.024 (c) – (d)

- A producer of less than 100,000 BTU equivalent barrels a day can apply for a tax credit of up to $12 million through 2016

<u>Daily Production in BTU equivalent barrels per day</u>

50,000 or less – tax credit is $12 million
60,000 – tax credit is $9.6 million
75,000 – tax credit is $6 million
90,000 – tax credit is $2.4 million
100,000 – tax credit reaches zero

Exploration Tax Credits 43.55.025

- Extends exploration tax credits six years to 2016
- 20% credit for exploration wells more than 3 miles from an existing well (C.I. deemed separate target)
- 20% for wells more than 25 miles from existing unit (10 miles for Cook Inlet)
- 40% credit if both conditions are met
- 40% credit for seismic operations not associated with a well

Tradable Capital Investment Tax Credits - 43.55.023 (a) – (h)

- 20% tax credit for qualified capital expenditures
- Unused credit can be applied in future years
- Transferable and re-transferable with a certificate
- Producers of less than 50,000 BTU equivalent barrels per day can get a cash refund if they meet certain qualifications
- Flexible for a wide variety of circumstances, can be cashed out, traded or saved

Transitional Investment Expenditures (TIE) - 43.55.023 (i)

- Up to a 20% credit for qualified TIE expenditures made between March 31, 2001 and April 1, 2006 if these capital expenditures would have qualified after March 31, 2006
- First calculate TIE amount for 5 years (2001-2006)
- You have 7 years to utilize before 2013 expiration
- Cannot exceed 10% of qualified cap ex. for year
- 20% regular credit + 10% TIE = 30% total possible

Useful websites

Link to BASIS for exact language of the new PPT law

http://www.legis.state.ak.us/PDF/24/Bills/HB3001Z.PDF

Department of Natural Resources – programs and incentives

http://www.dog.dnr.state.ak.us/oil/programs/programs.htm