"Alaska's Fiscal System: Does it Work for Industry and Communities?"

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Alaska Oil & Gas Association

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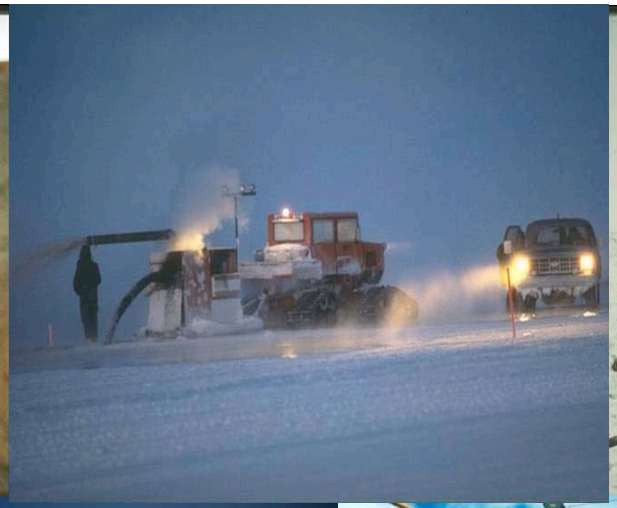
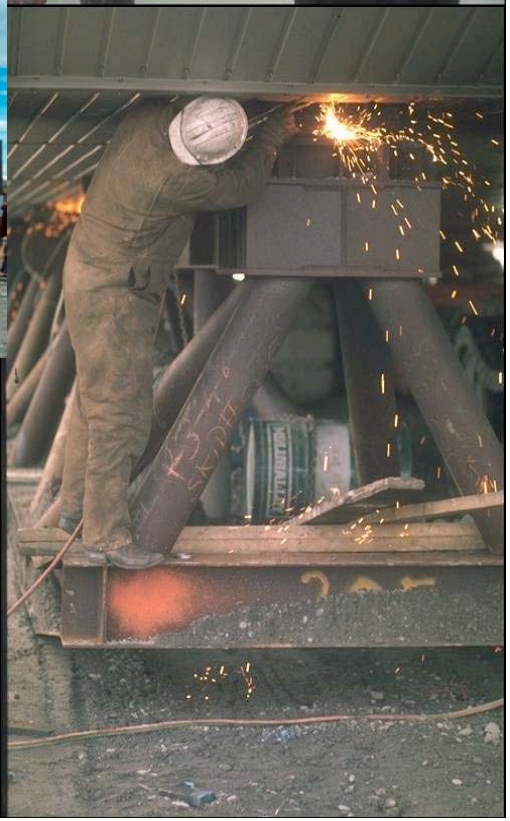
November 16, 2005

EXTRA
Anchorage Daily Times
WE'RE IN
64-20 VOTE
Victory Brings Quick Reactions
Anchorage Daily Times
RICHFIELD HITS OIL
PRODUCTION CHIEF FLIES HERE
Alaska Talks, Thinks Oil As Predictions Spread
Dulles Pleads For World Disarming
Lake Iliamna Blaze Nearly Under Control
Anchorage Daily Times
After Five Years, Two Months And 19 Days, It's Official:
PIPELINE WORK BEGINS
Alyeska Assigns 1200 Men To Road
Unions Schedule



ARCO Alaska, Inc.
Prudhoe Bay Unit - Well No. 9-48
SL: 935' N & 162' E of SW CR
Sec. 1 , T10N, R15E, UM
BHL: 1143' S & 789' E of NW CR
Sec. 8 , T10N, R16E, UM
State Lease No. ADL 28345
Drilling Permit No. 80-133
API: 50-029-20092



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to share Alaska's history

Since the Swanson River oil discovery in 1957, total petroleum revenue to the State of Alaska has been over $55.2 billion.

Overall Impacts of Oil and Gas Industry

- $3.0+ Billion to Alaska's Unrestricted General Fund
- 33,573 Jobs
- $1.4 Billion in Annual Payroll
- $1.8 Billion Value Added to Economy
- Oil and gas spending roughly equals state general fund spending
- Oil and gas has the largest private sector payroll
- Oil and gas is the State's largest taxpayer

“Alaska’s Fiscal System: Does it Work for Industry and Communities?”

Safety Moment

- Gazelle Video

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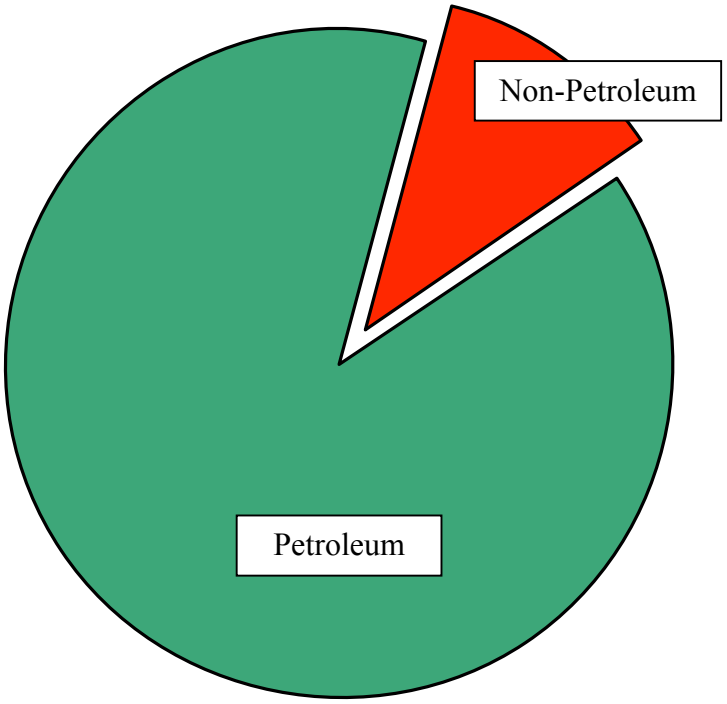
How Alaska's Fiscal System Works

FY05 Unrestricted Revenue



Oil revenues have provided from 70 to 90% of Alaska's Unrestricted General Purpose Revenue from 1979 – today.

Two elements are critical to the oil revenue forecast: price and volume.

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Existing Alaska Fiscal System (Actual FY04)

Royalty	$1,420MM
Production Tax	$652MM
Property Tax	$266MM
Corporate Income Tax	$299MM
Total	$2,637MM

Royalty figure includes Permanent Fund contribution ($362MM)
Property tax figure (also known as ad valorem) includes local government shares ($219MM)
Total (minus Permanent Fund, local property tax) represents 87% of unrestricted general fund revenue

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Royalty - The State's Ownership Share

- Contractual obligation of the leases
- Majority of leases are 12.5% of gross netback value
- New leases often have higher rates
- State option of royalty in kind or in value
- 25% dedicated to Permanent Fund

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Production (Severance) Tax

Tax = Gross Revenue x Base Tax Rate x ELF

Gross Revenue = Netback Value x Volume

Base Tax Rate = 12.25% for first 5 years; 15% thereafter

ELF – Economic Limit Factor

A formula that *increases* production tax for larger, highly productive fields and *decreases* production tax for smaller, low-production fields

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What Is ELF and Why Is It Important?

ELF – Economic Limit Factor

Only applies to production tax

Tax level based on well productivity and field size

Designed to reflect field production economics:

- To encourage full production from declining fields
- To encourage development of satellite & marginal fields
- To encourage development of heavy oil

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Property Tax

- Oil and gas is the only industry that is subject to a statewide property tax
- Unrelated to oil price
- State tax with credit for municipal payments
- 20 mil (2%) of assessed tangible facility values
- State share has declined as local taxes increased

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State Corporate Income Tax

- Tax applies to all corporations, excluding subchapter S, LLCs.
- Oil and gas industry pays 88% of the State's Corporate Income Tax.

Tax = (Worldwide Taxable Income x Apportionment Factor) x 9.4%

Worldwide Taxable Income (*includes refining and marketing profits)*

Apportionment factor for oil and gas = average of following percentages:

% of worldwide production in Alaska
% of worldwide property in Alaska
% of worldwide sales in Alaska

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Oil and Gas Tax Facts

- All fields in Alaska pay royalty, property and income tax
- Alaska's revenue base is protected when oil prices are low*
- State revenues increase with every dollar oil prices increase**
- ELF is working as intended to maximize production from declining, mature fields and encourage new production from new, smaller fields

- Over the last ten years, the median price of ANS West Coast spot was $21.69 per bbl. At this price, the state and municipal share is about 44%; the producer share is about 36% and the federal share is about 20%. For the prior ten year period, the median price of ANS West Coast spot was $18.52 per bbl. At this price, the state and municipal share is about 47%; the producer share is about 37%; and the rest is federal.

** For every $1 increase in oil prices, state income increases by about $70 million gross per year at production levels of 1 million barrels a day.

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Relative Shares of Net Revenue

Relative Shares of Net Revenue

ANS West Coast	**$ 15.00**	**$ 30.00**	**$ 45.00**	**$ 60.00**	**$ 75.00**	**$ 90.00**
Less Marine Transportation Cost	1.92	1.92	1.92	1.92	1.92	1.92
Less TAPS Tariff	3.60	3.60	3.60	3.60	3.60	3.60
Wellhead Value	9.48	24.48	39.48	54.48	69.48	84.48
Less Capital Recovery/Reinvestment	5.00	5.00	5.00	5.00	5.00	5.00
Less Operating Costs	2.00	2.00	2.00	2.00	2.00	2.00
Net Revenue	2.48	17.48	32.48	47.48	62.48	77.48
Royalty	1.11	2.99	4.86	6.74	8.61	10.49
Severance Tax	0.63	1.63	2.63	3.62	4.62	5.62
Ad Valorem Tax	0.70	0.70	0.70	0.70	0.70	0.70
State Income Tax	0.34	0.46	0.58	0.70	0.82	0.93
Federal Income Tax	(0.11)	4.10	8.30	12.50	16.71	20.91
Producer Share	(0.20)	7.61	15.41	23.22	31.03	38.83
Add Back Transport	0.80	0.80	0.80	0.80	0.80	0.80
FIT on Transport	0.43	0.43	0.43	0.43	0.43	0.43
Producer	0.60	8.41	16.21	24.02	31.83	39.63
State & Municipal	2.79	5.78	8.77	11.76	14.75	17.74
Federal	0.32	4.53	8.73	12.93	17.14	21.34
Producer Share	**16%**	**45%**	**48%**	**49%**	**50%**	**50%**
Government Share	**84%**	**55%**	**52%**	**51%**	**50%**	**50%**
State & Municipal Share	75%	31%	26%	24%	23%	23%
Federal Share	9%	24%	26%	27%	27%	27%

Notes:

The figures for Marine, TAPS, are from DOR Spring 2005 Revenue Sources Book.

The figures for Operating Cost and Capital Recovery are from DOR Fall 2002 Revenue Sources Book.

The Severance calculation uses the current 7.6% North Slope effective rate.

The State Income Tax Rate uses 2.36 cents / dollar price change from Fall Revenue Sources Book.

The Federal Income Tax Rate is the marginal 35% rate.

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Why Production Is Important

- DOR's revenue projections to 2015 depend entirely on new production to offset the decline of Alaska's super giant fields
- DOR's projections to 2015 depend on investments yet to be made – and on doubling the level of investment in the next four years
- DOR's projections rely on four distinct types of production: in field, satellite fields, wildcat fields, heavy oil

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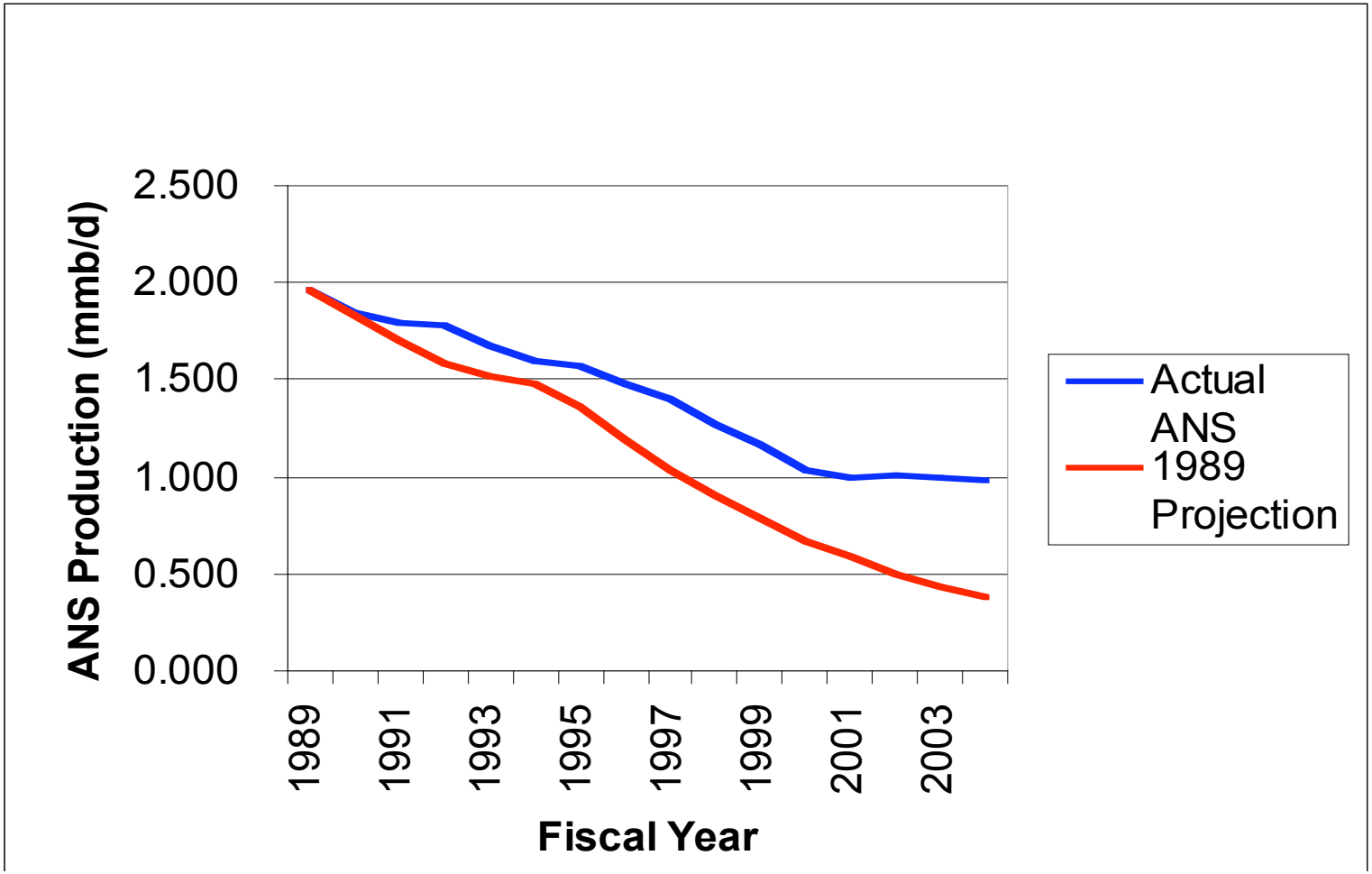
Historical ANS Production vs. 1989 Forecast



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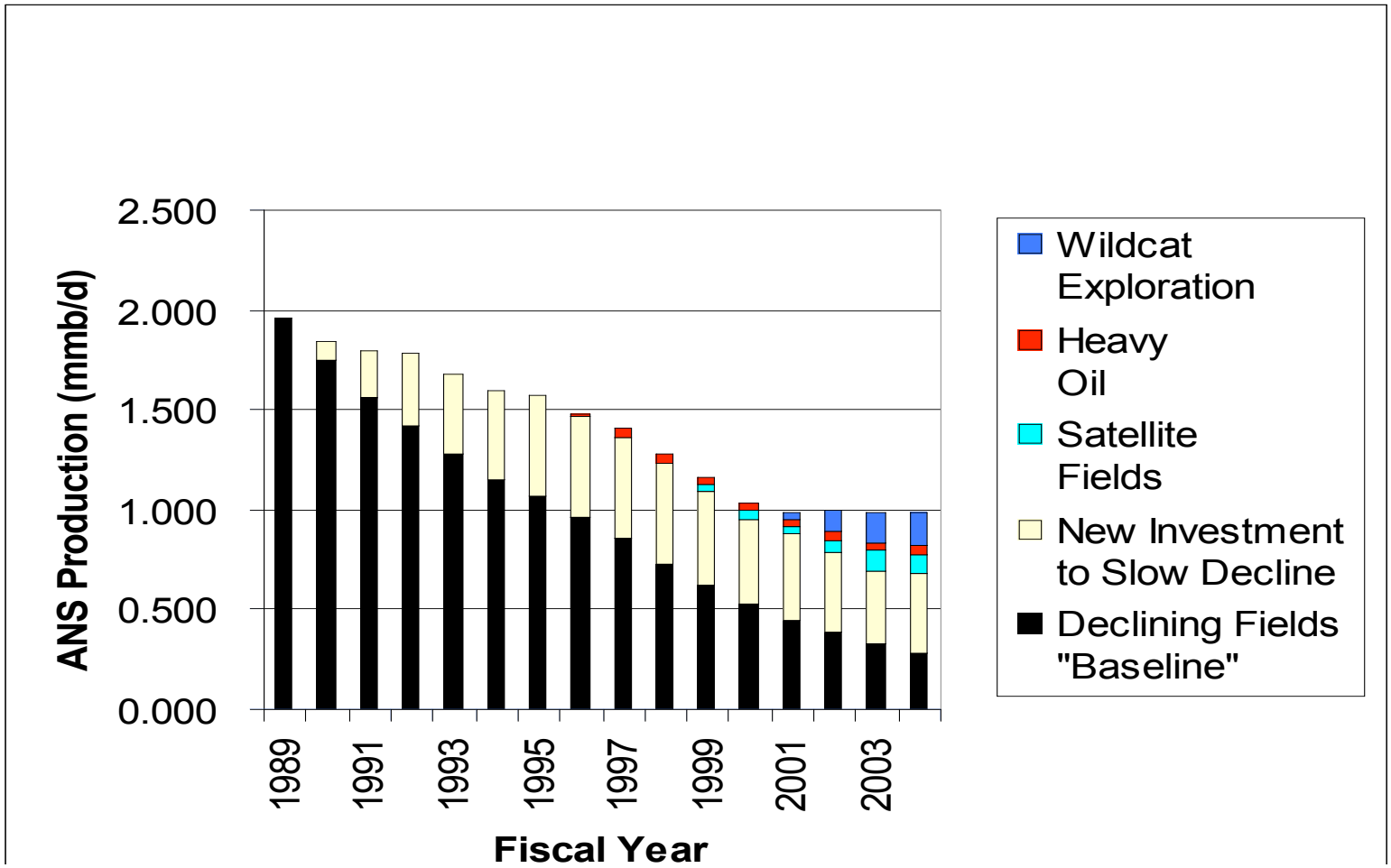
Historical Effects of Investment on Production



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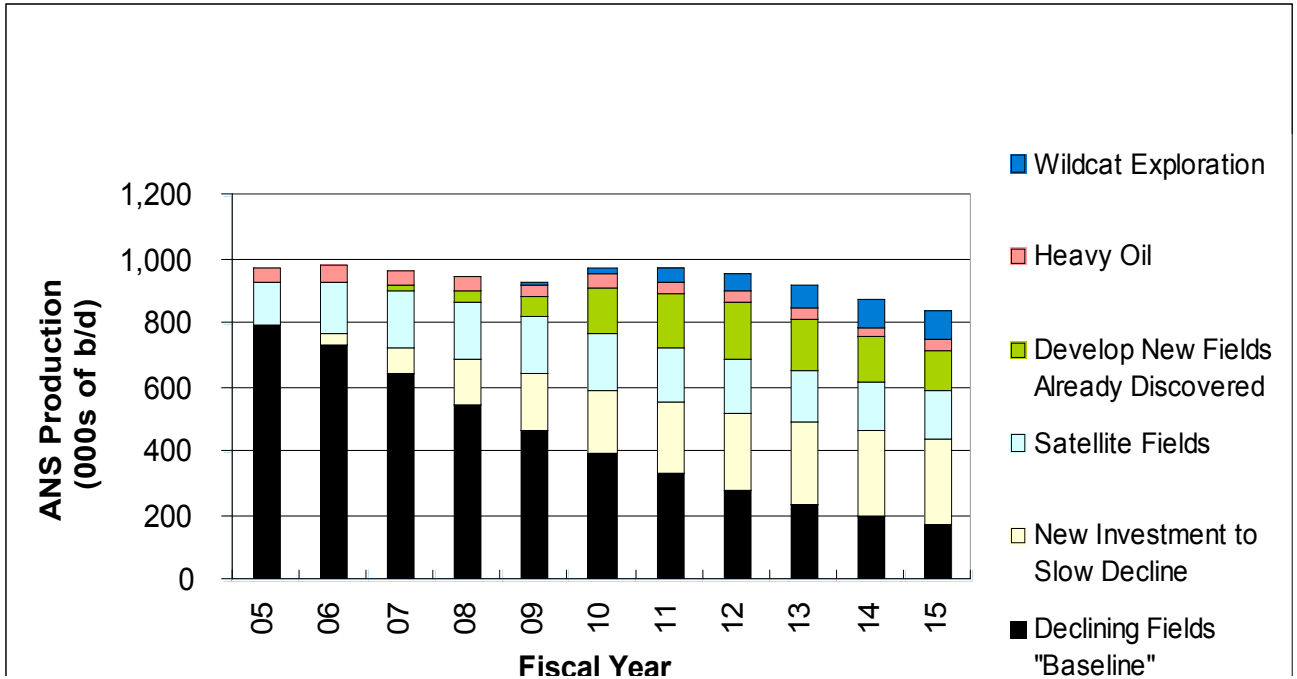
DOR Forecast to 2015: Contributions of Different Kinds of Investments in Additional Oil Production



SOURCE: DOR *Spring 2004 Revenue Source Book*, p. A5, "Historical and Projected Crude Oil Production".
Wildcat = "NPRA" production
Heavy Oil = "Milne Point" production
New Fields Already Discovered = "Fiord" + "Point Thomson" + "Liberty" + "Nanuk" + "Known Onshore" + "Known Offshore" production
Satellites = "PBU-Satellite" + "KRU-Satellite" production
Declining Fields "Baseline" = "Prudhoe Bay" + "Kuparuk" + "Endicott" + "GPMA" production declining at 15%/yr starting in mid-2006, plus "Alpine" and "Northstar" production without adjustment from DOR's forecast
New Investment to Slow Decline = difference between Prudhoe/Kuparuk/Endicott/GPMA "baseline" above and DOR's forecasted production from them

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The Public Policy Challenge

"There is no question that state government policy decisions will affect the level of investment in North Slope oil exploration and development. And State government decision-makers will have to decide what policies are most likely to maximize the public benefit from North Slope production." *Fall 2002 Revenue Sources Book*

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Policy Considerations

1. Will a particular fiscal policy make Alaska more or less competitive for oil and gas investments?
2. Will a particular fiscal policy encourage or discourage investment in each of the 4 types of production in Alaska?

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