Personal Correspondence from
D. Augustine HE to
E. Marchegiani APA

Natural Gas Wellhead Severance Taxes

HARZA-EBASCO *SUSITNA JOINT VENTURE*

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June 21, 1983

Mr. Eric Marchegiani
Alaska Power Authority
334 West 5th Avenue
Anchorage, Alaska 99501

Subject: Natural Gas Wellhead Severance Taxes

Dear Mr. Marchegiani:

Attached is a copy of Alaska Statutes, Chapter 55. Oil and Gas Properties Production tax. The section that specifies natural gas severance taxes is Section 43.55.016.

The minimum tax would be 6.4¢/Mcf while the maximum is 10% of the wellhead price. Actual taxes could be somewhere in between because the 10% quantity is multiplied by the "economic limit factor" described in Section 43.55.013.

At this time it is impossible to obtain the values needed to solve the economic limit factor for the new Enstar gas contracts since none of the wells covered by those contracts are currently producing. Bill Hickman of Enstar said they are currently paying about 11¢/Mcf on gas purchased from Beaver Creek and that the 11¢/Mcf was about 4% of the wellhead price. Charles Logsdon of the DOR said his rough guess would be about 7% of the wellhead price for the new Enstar contracts (0.07 x 2.32/Mcf = 16¢/Mcf).

Based on this information, I have assumed that the severance tax is 15¢/Mcf for new Cook Inlet gas and that the tax will increase or decrease as the gas price changes with world oil prices.

If you have any questions concerning this matter, please call me.

Very truly yours,

W. David Augustine

W. David Augustine

WDA/kdn
Attachments: as noted
cc: Robert Mohn, APA
Henry H. Chen, HE
Ned Lesnick, HE

Chapter 55. Oil and Gas Properties Production Tax.

Sec. 43.55.010. Gross production tax. Repealed by § 9 ch 136 SLA 1977.

Editor's note. — The repealed section derived from § 2, ch. 7, ESLA 1955; § 1, ch. 110, SLA 1968; § 1, ch. 247, SLA 1970; §§ 1 — 3, ch. 101, SLA 1972; § 49, ch. 53, SLA 1973; § 1, ch. 4, FSSLA 1973; § 2, ch. 159, SLA 1975.

Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Legislative committee report. — For report on ch. 247, SLA 1970 (HCS for SB 200 am S), see 1969 House Journal, p. 4[illegible]; for report on ch. 101, SLA 1972 (HCSSB 168), see 1972 House Journal, p. 963. For report on ch. 53, SLA 1973 (HCSSB 382), see 1973 House Journal, p. [illegible].

Sec. 43.55.011. Oil production tax. (a) There is levied upon the producer of oil a tax for all oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax is equal to either the percentage-of-value amount calculated under (b) of this section or the cents-per-barrel amount calculated under (c) of this section, whichever is greater, multiplied by the economic limit factor determined for the oil production of the lease or property under § 13 of this chapter. If the amounts calculated under (b) and (c) of this section are equal, the amount calculated under (b) of this section shall be treated as if it were the greater for purposes of this section.

(b) The percentage-of-value amount equals 12.25 per cent of the gross value at the point of production of taxable oil produced from the lease or property.

(c) The cents-per-barrel amount equals $0.60 per barrel of taxable old crude oil produced from the lease or property, and $0.60 per barrel for all other taxable oil produced from the lease or property, both as adjusted by § 12 of this chapter.

(d) When the cents-per-barrel amount calculated under (c) of this section is greater than the percentage-of-value amount calculated under (b) of this section, and payment by the state to the Alaska Native Fund out of the state's royalties on that oil is required under the revenue sharing provisions of § 9 of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601 et seq.), that payment shall be not less than $.05 for each taxable barrel of oil produced until all amounts paid in the fund equal $500,000,000. (§ 1 ch 136 SLA 1977)

Cross reference. — As to oil and gas, see AS 38.05.180.

Editor's note. — Section 10, ch. 136, SLA 1977 provides, in subsection (b): "If a court of competent jurisdiction invalidates the differential cents-per-barrel amounts set out in AS 43.55.011(c), then the cents-per-barrel amount under that section shall be $0.80 per barrel for all crude oil."

Section 11, ch. 136, SLA 1977, effective July 1, 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Legislative committee report. — For report on ch. 136, SLA 1977 (HCSCSSB 238), see 1977 House Journal, p. 1248.

Am. Jur. reference. — 51 Am. Jur., Taxation, §§ 438, 439, 1259.

Sec. 43.55.012. Adjustment in tax rates. (a) Before January 1 of each year, the department shall review the prices received for crude oil or gas produced in Alaska, the value of that oil or gas, and the general level of prices in Alaska and the nation, and submit a written report of this review to the governor with the department's recommendations for changes in the amounts set out in §§ 11(c) and 16(c) of this chapter. The governor shall, within 30 days of receiving the department's report, submit the proposed changes to the amounts in §§ 11(c) and 16(c) of this chapter to the legislature.

(b) The cents-per-barrel amount set out in § 11(c) of this chapter as adjusted by (a) of this section applies to oil of 27 degrees API gravity. For each degree of API gravity less than 27 degrees the cents-per-barrel amount shall be reduced by $.005 and for each degree of API gravity greater than 27 degrees the cents-per-barrel amount shall be increased by $.005 except that oil above 40 degrees API gravity shall be taxed as 40 degree oil. In applying the gravity adjustment under this subsection, fractional degrees of API gravity shall be disregarded. (§ 1 ch 136 SLA 1977)

Editor's note. — Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Sec. 43.55.013. Economic limit factor. (a) The economic limit factor for old crude oil production of a lease or property equals one minus the ratio of the monthly production rate at the economic limit to the production during the month for which the tax is to be paid.

(b) The economic limit factor for oil production of a lease or property other than old crude oil equals:

$$(1-[PEL/TP])\ \exp\ ([460 \times WD]/PEL)$$

where: PEL = the monthly production rate at the economic limit;

TP = total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

(c) The economic limit factor for gas production of a lease or property equals one minus the ratio of the monthly production rate at the economic limit to the production during the month for which the tax is to be paid.

(d) The monthly production rate at the economic limit for a lease or property is presumed to be 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. The taxpayer may rebut this presumption at a formal hearing under AS 43.05.240 by providing clear and convincing evidence of a different monthly production rate at the economic limit for the lease or property. The hearing shall be held before February 15 of the year or within six months after commencement of oil production for a lease or property. The monthly production rate at the economic limit for the lease or property based upon the clear and convincing evidence of the taxpayer shall be calculated by dividing the value determined under (f) of this section into the average monthly direct operating cost determined under (e) of this section and shall be used for purposes of this section for all oil production during that calendar year from the lease or property.

(e) The average monthly direct operating cost for oil production operations of the lease or property shall be determined based on a period of not less than four consecutive months. The direct operating costs include only royalty, production supplies, purchased fuel, routine maintenance, and wages and benefits of employees working on the production operations. Additional direct operating costs not listed in this section may be included only after their inclusion in a regulation adopted by the department. The direct operating costs do not include capital expenditures, tangible or intangible drilling expenses, costs of well workovers, costs for replacement or repairs (other than routine maintenance), depreciation or amortization, taxes, insurance, overhead, money paid or set aside (or booked as being paid or set aside) to cover the cost of terminating the oil production operations of the lease or property, or any other cost not directly related to the oil production operations of the lease or property.

(f) For the purpose of calculating the economic limit, the value at the point of production of oil produced from the lease or property shall be determined on the basis of the acquisition cost C.I.F. at West Coast refineries for imported oil of like quality, minus the reasonable cost of transportation between the point of production of the oil from the lease or property and those West Coast refineries.

(g) Before February 15 of each year or within six months after commencement of production for a lease or property, the department shall notify the producer of gas of the monthly production rate at the

economic limit for each lease or property in the state for that year. The monthly production rate at the economic limit for a lease or property shall be determined at a formal hearing under AS 43.05.240 and must be established by clear and convincing evidence presented by the taxpayer at that hearing. The monthly production rate at the economic limit for the lease or property based upon the clear and convincing evidence of the taxpayer shall be calculated by dividing the value determined under (i) of this section into the average monthly direct operating cost determined under (h) of this section.

(h) The average monthly direct operating cost for gas production operations of the lease or property shall be determined based on a period of not less than four consecutive months. The direct operating costs include only royalty, production supplies, purchased fuel, routine maintenance, and wages and benefits of employees working on the production operations. Additional direct operating costs not listed in this section may be included only after their inclusion in a regulation adopted by the department. The direct operating costs do not include capital expenditures, tangible or intangible drilling expenses, costs of well workovers, costs for replacement or repairs (other than routine maintenance), depreciation or amortization, taxes, insurance, overhead, money paid or set aside (or booked as being paid or set aside) to cover the cost of terminating the gas production operations of the lease or property, or any other cost not directly related to the gas production operations of the lease or property.

(i) For the purpose of calculating the economic limit, the value at the point of production of gas produced from the lease or property shall be determined on the basis of the highest price paid for gas of like quality and pressure in the same field.

(j) The department may aggregate two or more leases or properties (or portions of them), for purposes of determining economic limit factors under this section and applying them to § 11 or § 16 of this chapter, when economically interdependent oil or gas production operations are not confined to a single lease or property. The department may also segregate a lease or property into two or more parts, for purposes of determining economic limit factors under this section and applying them under § 11 or § 16 of this chapter, when two or more economically independent oil or gas production operations are being conducted on it, or when old crude oil is produced from the same lease or property as new oil.

(k) A determination of the monthly production rate at the economic limit for a lease or property is retroactive to January 1 of the current year. For production of a lease or property commencing after January 1, the determination of the monthly production rate at the economic limit for that lease or property made within six months after the commencement of production is retroactive to the commencement of production. (§ 1 ch 136 SLA 1977)

Editor's note. — Section 10, ch. 136, SLA 1977, provides, in subsection (a): "If a court of competent jurisdiction invalidates the differential economic limit factor computation under AS 43.55.013(a) and (b), the economic limit factor contained in (b) of that section shall be used for computation of the economic limit for all oil."

Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Sec. 43.55.015. Tax per barrel of oil.

Repealed by § 9 ch 136 SLA 1977.

Editor's note. — The repealed section derived from § 4, ch. 101, SLA 1972; § 2, ch. 4, FSSLA 1973.

Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Legislative committee report. — For report on ch. 101, SLA 1972 ([illegible] 168), see 1972 House Journal, p. [illegible]

Sec. 43.55.016. Gas production tax. (a) There is levied upon the producer of gas a tax for all gas produced from each lease or property in the state, less any gas the ownership or right to which is exempt from taxation. The tax is equal to either the percentage-of-value amount calculated under (b) of this section or the cents-per-Mcf amount calculated under (c) of this section, whichever is greater, multiplied by the economic limit factor determined for gas production of the lease or property under § 13 of this chapter. If the amounts calculated under (b) and (c) of this section are equal, the amount calculated under (b) of this section shall be treated as if it were the greater for purposes of this section.

(b) The percentage-of-value amount equals 10 per cent of the gross value at the point of production of the taxable gas produced from the lease or property.

(c) The cents-per-Mcf amount equals $.064 per thousand cubic feet of taxable gas produced from the lease or property as adjusted by § 13 of this chapter. (§ 1 ch 136 SLA 1977)

Editor's note. — Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Sec. 43.55.017. Relation to other taxes. (a) Except as provided in this chapter and in ch. 58 of this title, the taxes imposed by this chapter are in place of all taxes now imposed by the state or any of its municipalities, and neither the state nor a municipality may impose a tax upon

(1) producing oil or gas leases;

(2) oil or gas produced or extracted in the state;

(3) the value of intangible drilling and exploration expenses.

(b) The taxes imposed by this chapter are in place of all taxes imposed by a municipality upon oil or gas in place or nonproducing oil or gas leases or properties.

(c) The taxes imposed by this chapter are not in place of th
posed by ch. 57 of this title or income taxes, franchise taxes or
upon the retail sale of oil or gas products. (§ 1 ch 136 SLA 1977)

Editor's note. — Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July and succeeding months."

Sec. 43.55.018. Credit against tax. (a) There shall be allowed credit against the taxes levied under this chapter for a lease or prop the early development incentive credit accrued for that lease or prop under AS 43.58.180. In no event may the credit allowed for a lea property exceed 50 per cent of the taxes levied under this chapte that lease or property.

(b) The credit shall be allowed on a monthly basis. (§ 2 ch 159 1975)

Editor's note. — Section 8, ch. 159, SLA 1975 contains a severability clause.

Section 9, ch. 159, SLA 1975, effective June 26, 1975, provides: "AS 43.58.030, 43.58.180, and AS 43.55.018 are included in this Act so as to avoid double taxation of the same interest in oil and gas and as an incentive for the early production of oil and gas discovered in the state. The legislature believes that the inclusion of these sections granting tax credits does not in any m change the intent, validity or enforce of the basic ad valorem tax imposed l Act. If the inclusion of these se results in a judicial decision that t valorem tax imposed by AS 43.58.(invalid, these sections shall be void a no effect whatsoever and the Act sh read as if these sections had never included."

Sec. 43.55.020. Payment of tax. (a) The gross production tax o or gas shall be paid monthly. The tax is due on the 20th day of calendar month on oil or gas produced from each lease or prop during the preceding month. If the tax is not paid before the end of month in which it becomes due, the tax becomes delinquent.

(b) The gross production tax on oil or gas shall be paid by or on be of the producer.

(c) Repealed by § 7 ch 101 SLA 1972, effective July 1, 1972.

(d) In making settlement with the royalty owner the producer deduct the amount of the tax paid on royalty oil or gas, or may de royalty oil or gas equivalent in value at the time the tax becomes to the amount of the tax paid.

(e) Gas produced in excess of that needed for safety purposes, exc gas used in the operation of a lease or property in drilling fo producing oil or gas, or for repressuring, is considered, for the purp of this chapter and in the amount used, as gas produced from a le or property. Gas flared beyond the amount authorized for safety by Department of Natural Resources under AS 31.05.170(11)(H) considered as gas produced, except that it is subject to a penalty eq to the tax computed under § 16 of this chapter as adjusted by § 12 this chapter per thousand cubic feet of gas for the month in which gas was flared.

(A) a mineral interest,

(B) a leasehold interest,

(C) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest or any other interest in a lease, concession, joint venture or other agreement for oil and gas exploration, development or production,

(D) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest or any other interest in an agreement for unitization or pooling under the provisions of sec. 614(b)(3) of the Internal Revenue Code of 1954 as defined on the effective date of this paragraph;

(9) "ownership or right to which is exempt from taxation" means an ownership interest of the federal government or the state;

(10) Repealed by § 9 ch 136 SLA 1977.

(11) Repealed by § 9 ch 136 SLA 1977.

(12) "gross value at the point of production"

(A) for oil, the value of the oil at the point where it is metered or measured (by automatic custody transfer meter, tank gauge or other method approved by the commissioner) in a condition of pipeline quality on the premises of the lease or property from which it is recovered; however, if the oil is not of pipeline quality when it is removed from the premises of the lease or property from which it is recovered, or if the oil recovered from a lease or property is not metered or measured (by automatic custody transfer meter, tank gauge, or other method approved by the commissioner) on the premises of the lease or property from which it is recovered, then the gross value at the point of production is the value of that oil at the off-premises location where the oil is first metered or measured (by automatic custody transfer meter, tank gauge, or other method approved by the commissioner) in a condition of pipeline quality;

(B) for gas recovered from or in association with oil, the value of the gas at the point where it is accurately metered or measured after separation from the oil; for gas run through a gas processing plant, the gross value at the point of production is the full consideration received by the producer for the gas if sold in an arm's length transaction or, in the absence of an arm's length transaction, is the sum of the value of the liquids extracted from the gas at the plant and the value of the residue gas, less a reasonable allowance for processing the gas at the plant and for transporting the gas to the plant from the premises upon which the oil production operation is conducted; and

(C) for gas not recovered from or in association with oil, the value of the gas at the point where it is accurately metered or measured, or the value of the gas at the point of sale, if any, on the premises of the lease or property from which the gas is recovered, whichever is the higher value; for gas run through a gas processing plant, the gross value at the point of production is the full consideration received by the producer for the gas if sold in an arm's length transaction or, in the absence of an arm's length transaction, is the sum of the value of the liquids extracted from the gas at the plant and the value of the residue gas, less a reasonable allowance for processing the gas at the plant and for transporting the gas to the plant from the point where it was accurately metered or measured;

(13) "oil production operation" means the operation by which oil is recovered from a lease or property and rendered into oil of pipeline quality, and includes any gathering done before the oil is finally rendered into oil of pipeline quality;

(14) "pipeline quality" means good and merchantable condition;

(15) "well days" means the number of days in which a well is producing during a month;

(16) "old crude oil" means crude oil production classified as "old crude oil" in 10 CFR Chapter II Part 212-72 on May 1, 1977, and which is also classified as "old crude oil" on the date of production. (§ 1 ch 7 ESLA 1955; am § 17 ch 101 SLA 1972; am § 3 ch 4 FSSLA 1973; am § 4 ch 8 SLA 1975; am §§ 7, 9 ch 136 SLA 1977)

Effect of amendments. — The 1973 amendment added paragraphs (6) — (11). The 1975 amendment rewrote paragraph (8).

The 1977 amendment repealed paragraphs (10) and (11), which defined "field" and "production," respectively, and added paragraphs (12) through (16).

Editor's note. — Section 8, ch. 159, SLA 1972 contains a severability clause.

Section 11, ch. 136, SLA 1977, provides: "This Act applies to production during the month of July, 1977 and succeeding months."

Legislative committee report. — For report on ch. 101, SLA 1972 (FCCS HCSSB 168), see 1972 House Journal, p. 963.

Sec. 43.55.150. Determination of gross value. (a) For the purposes of this chapter, the gross value shall be calculated using the reasonable costs of transportation of the oil or gas. The reasonable costs of transportation shall be the actual costs, except

(1) when the parties to the transportation of oil or gas are affiliated;

(2) when the contract for the transportation of oil or gas is not an arm's length transaction or is not representative of the market value of that transportation;

(3) when the method of transportation of oil or gas is not reasonable in view of existing alternative methods of transportation.

(b) If the department finds that the conditions in (a) (1), (2), and (3) of this section are present, the department shall determine the reasonable costs of transportation, using the fair market value of like transportation, the fair market value of equally efficient and available alternative modes of transportation, or other reasonable methods. Transportation costs fixed by tariff rates properly on file with the Alaska Pipeline Commission or other regulatory agency shall be considered prima facie reasonable. (§ 6 ch 107 SLA 1976)