
Progressivity & State 'Participation'

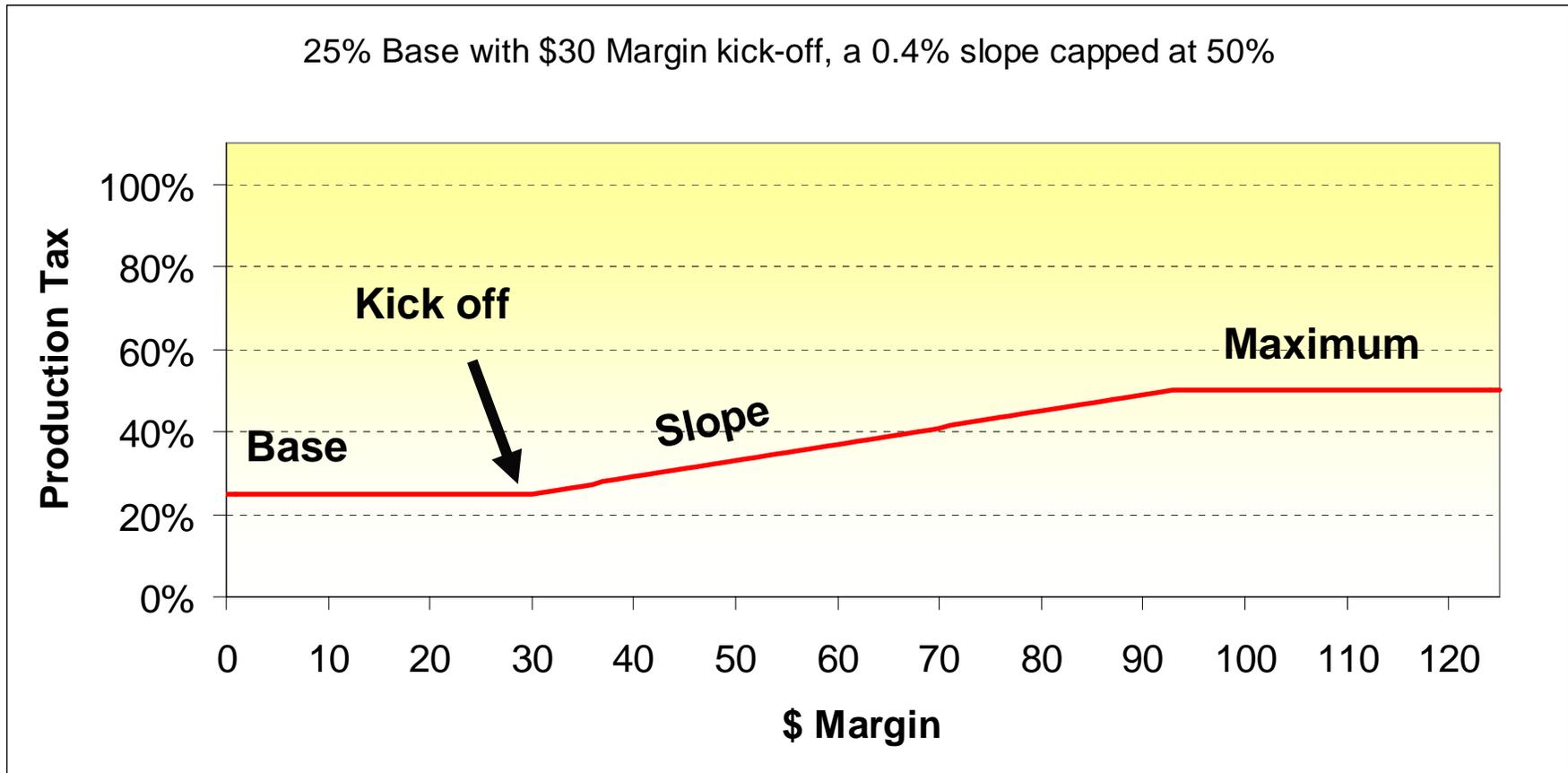


Progressivity

- **Highly progressive systems are best understood by examining the tax impacts of a \$1 change in Margin**
 - Recall price does not equal margin
 - Margin under ACES is the net company cash flow before taxes



Hypothetical Progressivity Structure



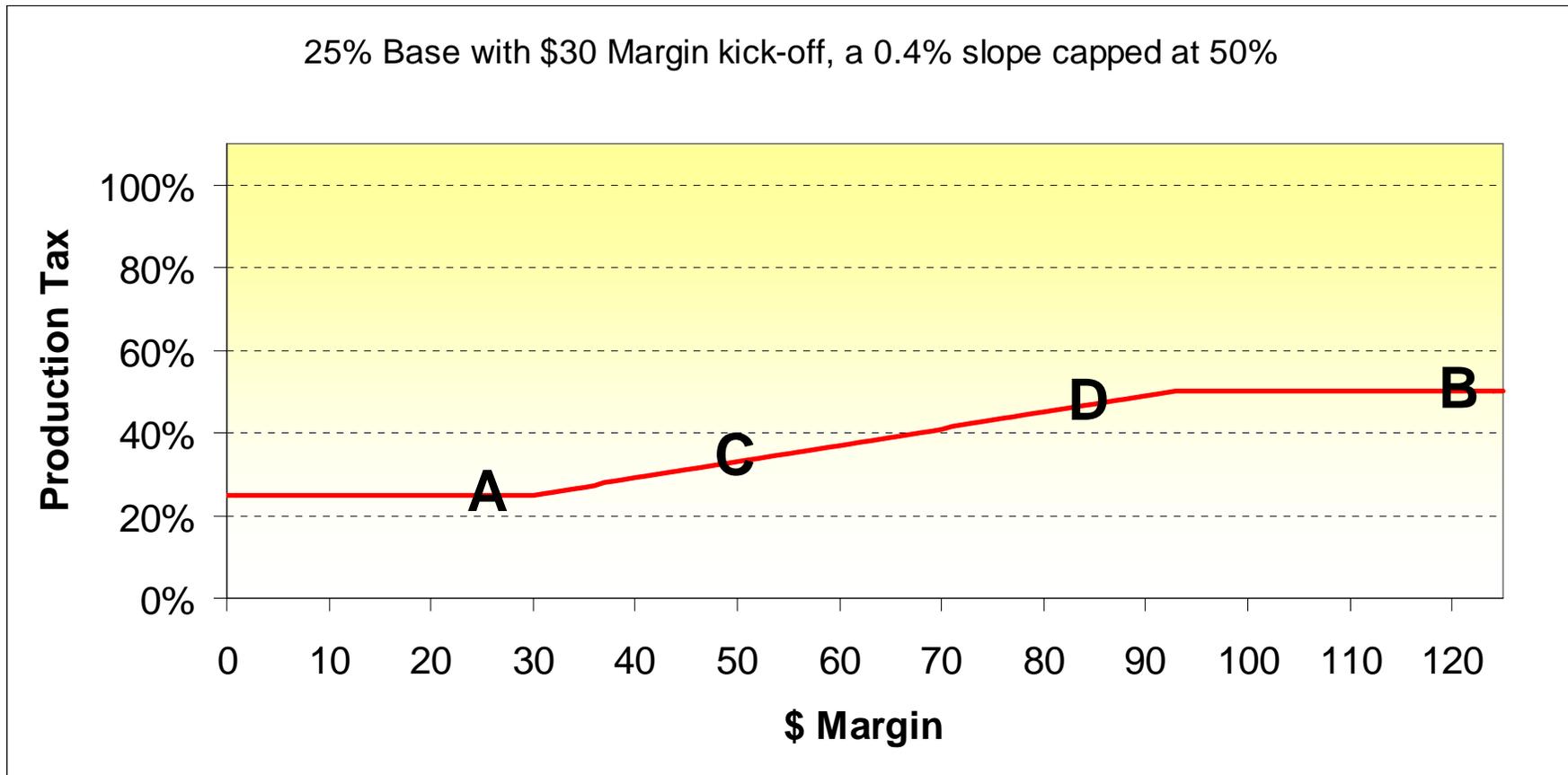


An Example of Progressivity Impacts

- **Let's assume a company has \$1000 before tax cash flow and is looking to make a \$100 investment**
 - Margin before investment is under \$30/bbl
 - Production tax savings associated with the \$100 investment is 25%
 - Margin is greater than \$92.5/bbl
 - Production tax savings associated with the \$100 investment is 50%
 - Margin is between \$31/bbl and \$92.5/bbl
 - Production tax savings associated with the \$100 investment ranges from 25% to over 100%



Hypothetical Margin Cases



Federal and State Income tax impacts excluded



Taxpayer 'A' - Low Margin

- **\$1000 net revenue @ a margin of \$25/bbl**
 - Tax = \$1000 x 25%
 - Tax = \$250
- **Now we invest \$100- reduces net revenue to \$900 and our margin to \$22/bbl**
 - Tax = \$900 x 25%
 - Tax = \$225
- **Production Tax savings due to the investment**
 - Tax Savings = $(\$250 - \$225)/\$100$
 - Tax Savings = $25/100$
 - New Marginal Tax Rate = 25%



Taxpayer 'C' – Low on the slope

- **\$1000 net revenue @ a margin of \$50/bbl**
 - Tax = \$1000 x 33%
 - Tax = \$330
- **Now we invest \$100 that takes our net revenue to \$900 and our margin to \$45/bbl**
 - Tax = \$900 x 31%
 - Tax = \$279
- **Production Tax savings due to the investment**
 - Tax Savings = $(\$330 - \$279)/\$100$
 - Tax Savings = 51/100
 - New Marginal Tax Rate = 51%

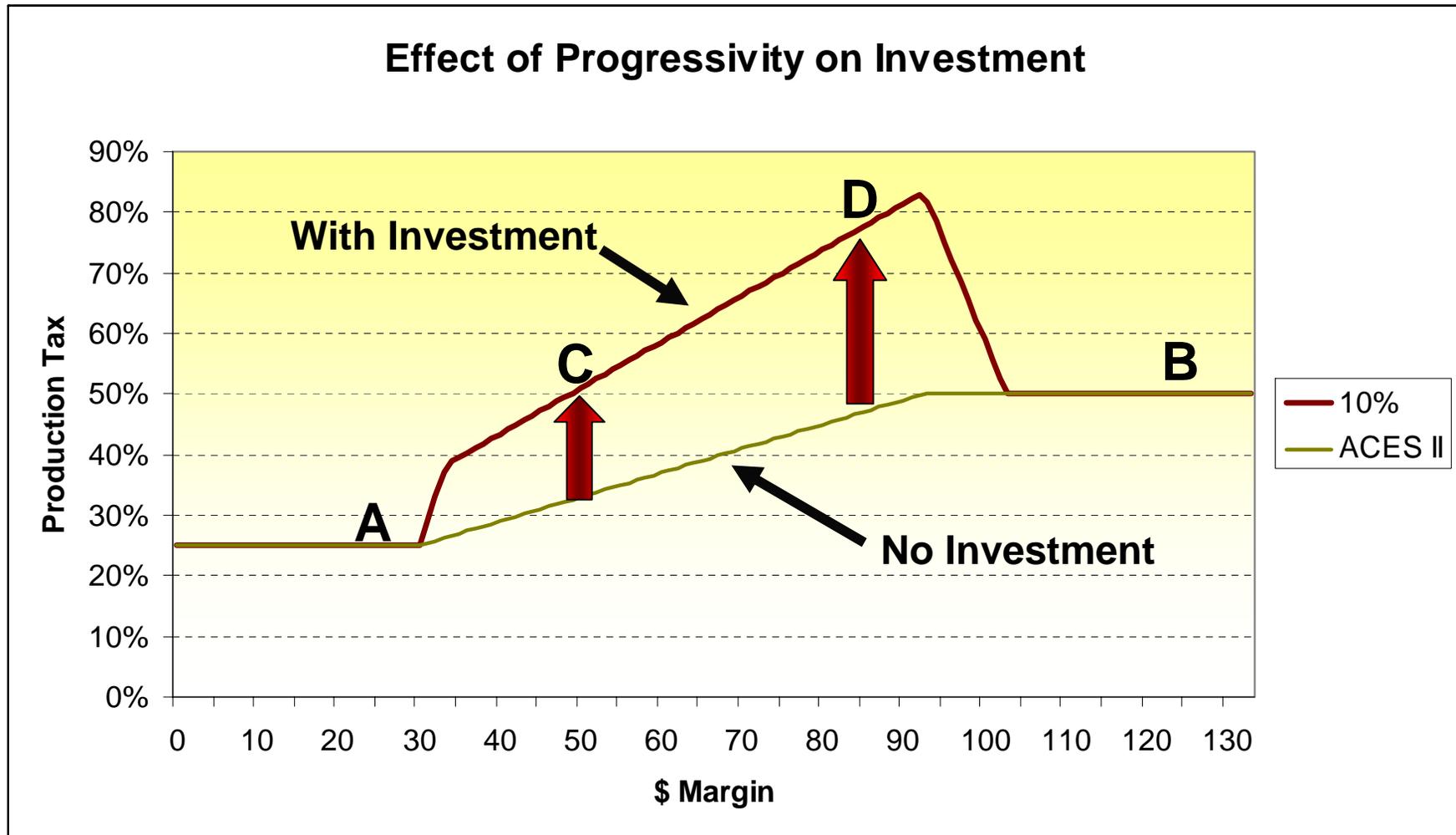


Taxpayer 'D' – High on the slope

- **\$1000 net revenue @ a margin of \$85/bbl**
 - Tax = \$1000 x 47%
 - Tax = \$470
- **Now we invest \$100 that takes our net revenue to \$900 and our margin to \$72/bbl**
 - Tax = \$900 x 43.6%
 - Tax = \$392
- **Production Tax savings due to the investment**
 - Tax Savings = $(\$470 - \$392)/\$100$
 - Tax Savings = 78/100
 - New Marginal Tax Rate = 78%

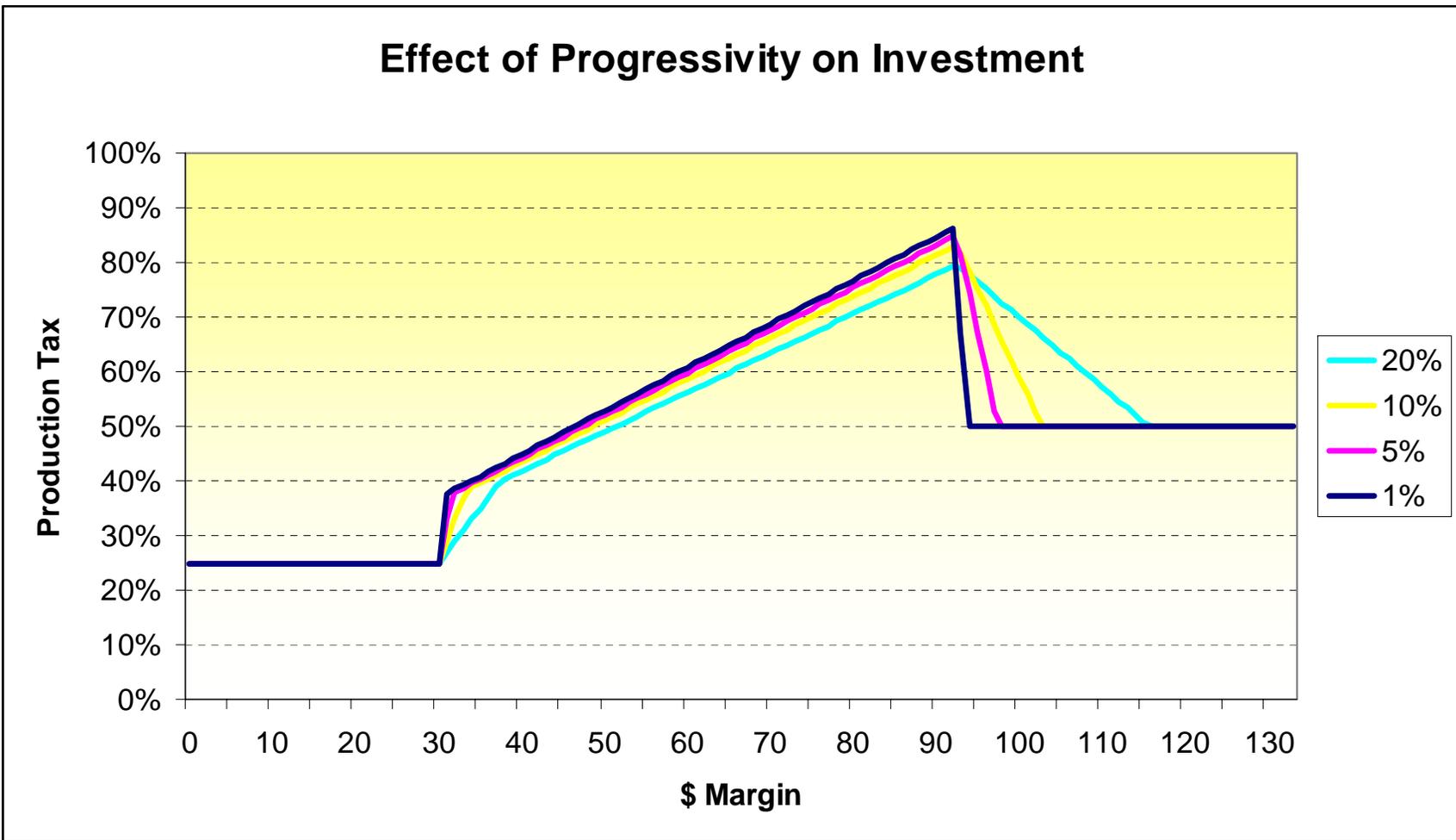


'C' & 'D' New Marginal tax rate higher



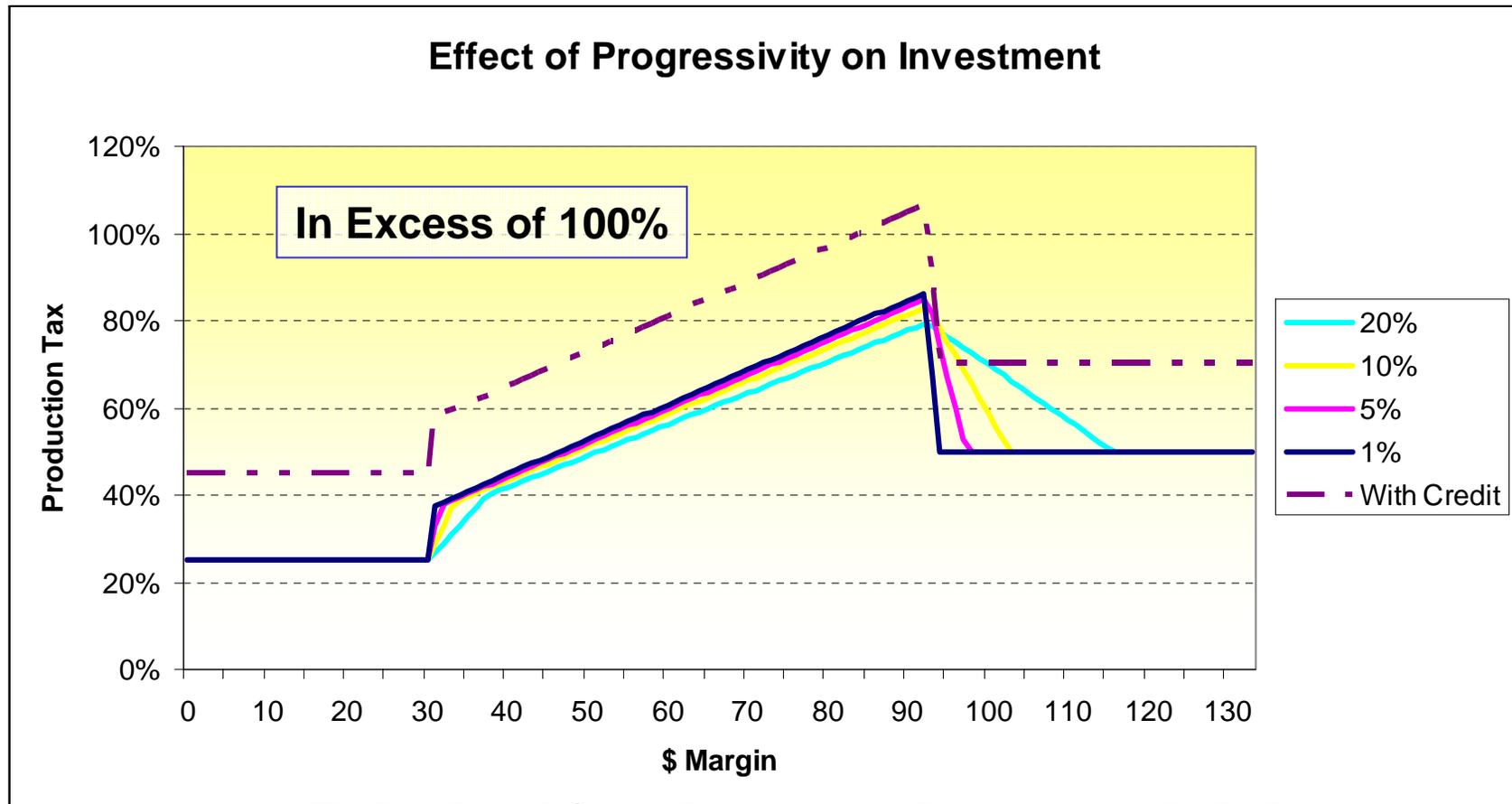


Investment as % of Cash Flow





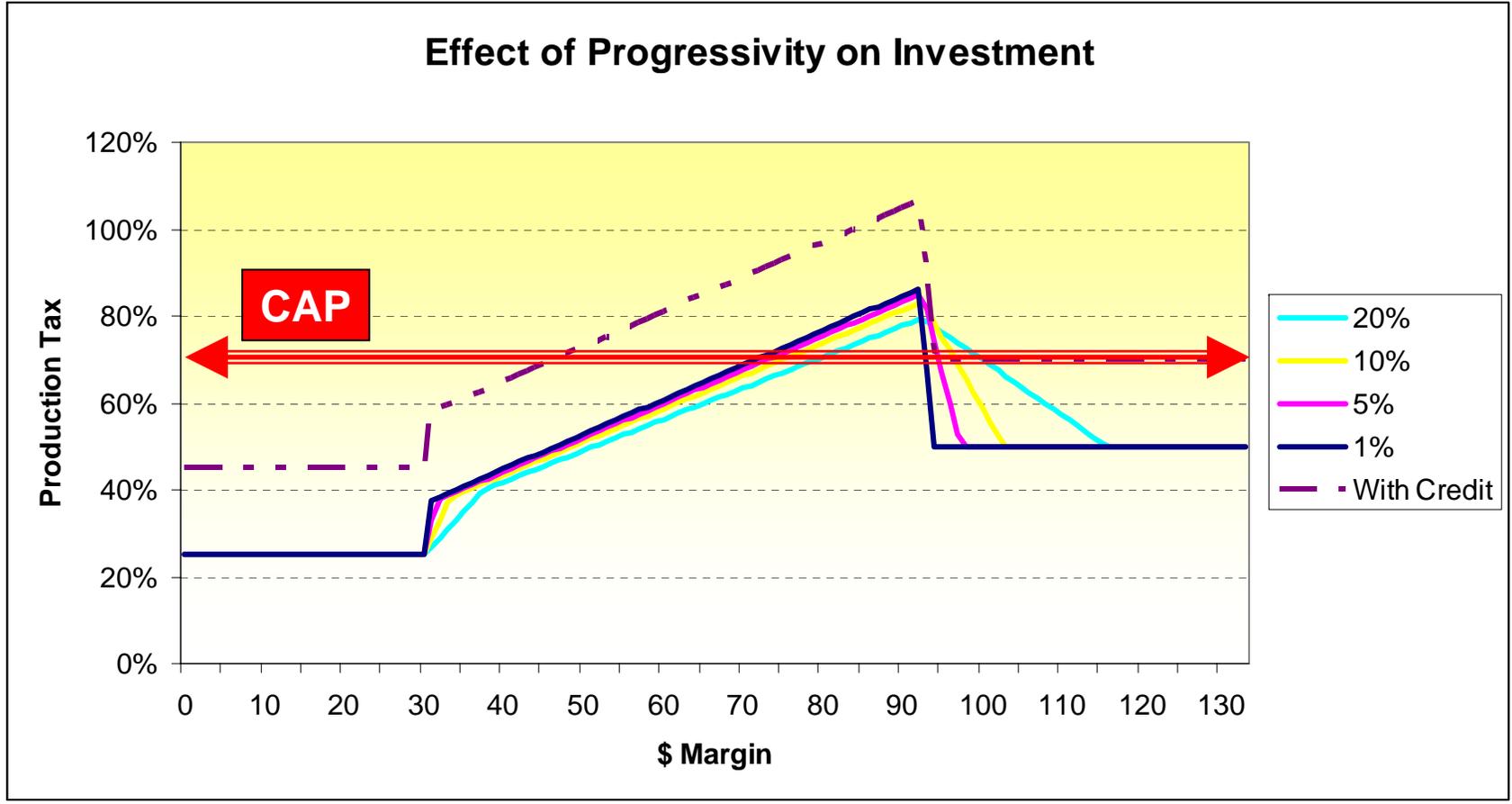
Add 20% Investment Credit



Federal and State Income tax impacts excluded



Is a cap advisable?





Capping State Share of Costs

- **The impact of progressivity varies with changes in any of the following:**
 - Base rate (e.g. 25%)
 - Kick off point (e.g. \$30 margin)
 - Progressivity Slope (e.g. 0.40%)
 - Maximum production tax (e.g. 50%)
 - Investment credit rate (e.g. 20%)
- **Once these items are determined, a formula can be drafted to ensure the incremental impact on state is capped a fixed level.**



Possible Capping Mechanism

- **Calculate tax under standard net tax legal structure (e.g. ACES with allowable deductions and credits)**
- **Calculate the Cap**
 - Calculate tax without qualifying capital expenditures
 - Allow a tax credit of 70% of the qualifying capital expenditures
- **Pay the larger of the two final tax computations**
- **Effectively places a cap on production tax incentives for investment**