SEVERANCE TAXES

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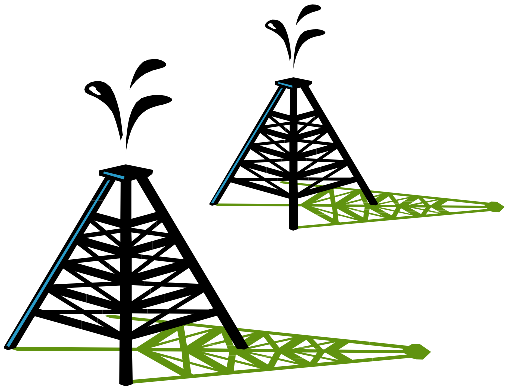
TAX POLICY ISSUES RELATED TO NATURAL GAS PRODUCTION

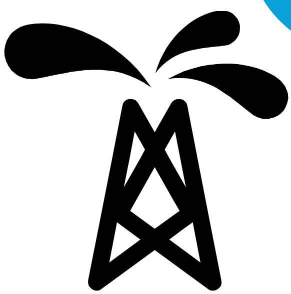


- What to tax?
- How to tax it?
- What do other states do?
- How is NC is different from other states?
- Whether/how should those differences impact NC tax policy?
- Incentives to draw developers here?

THE DIFFERENT PHASES OF NATURAL GAS PRODUCTION

Explore

Drill



Production

Prepare for Transport

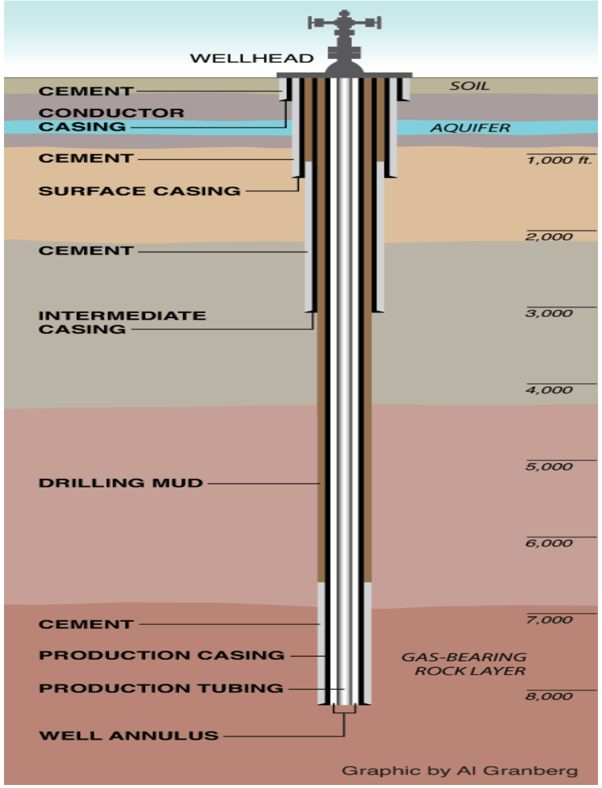
Distribution

WELL DRILLING COSTS

Permitting, surveying, drilling rig operational costs, drill pipe, bits, drilling fluid, surface expenses, etc.

WELL COMPLETION COSTS

Costs to prepare the well for production of natural gas: Includes: steel pipe casing, cementing of casing, logging, perforating, fracturing, acidizing, etc.



MARKETING COSTS

Costs incurred to get gas from the wellhead to market (first purchaser)
Includes: compression, treating, dehydrating, delivery, etc.

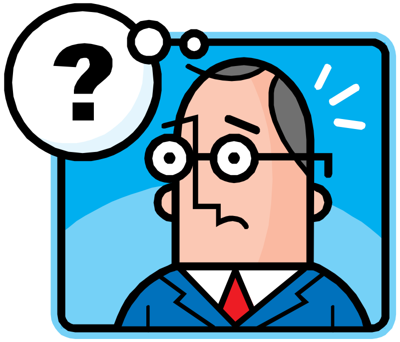
OTHER TERMS DEFINED

- MCF – 1000 cubic feet of natural gas
- Royalty interest – interest in mineral rights in a lease (separate from working interest)
- Working interest – interest in profits from well after all expenses and royalties are paid out
- Payout – when gas sales generate sufficient revenue to recover all drilling, completion, and operating costs incurred for that well

OTHER TERMS DEFINED

- Intangible drilling costs – all drilling and completion costs that are not for tangible property; (drilling rig fees, drilling mud, logging, etc.)
- Depletion – the “using up” of natural resources though production (similar to depreciation for tangible assets)

WHAT IS A SEVERANCE TAX?



A tax imposed on the producer of oil, gas or other minerals when they are removed from the ground

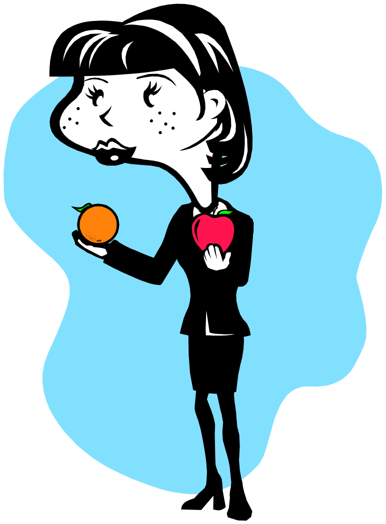
HOW IS SEVERANCE TAX COMPUTED?

Rate

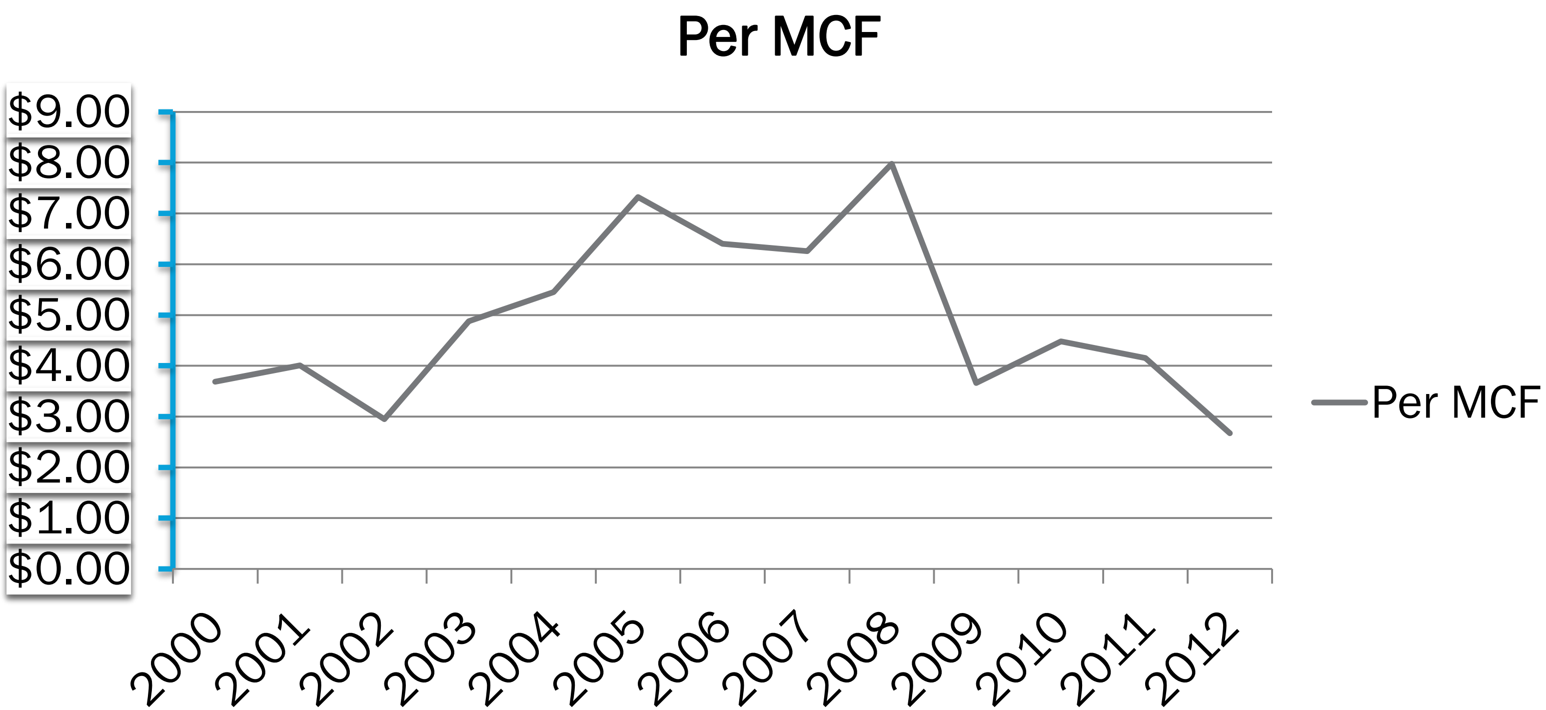
x

Base

= Total tax



PRICE OF NATURAL GAS



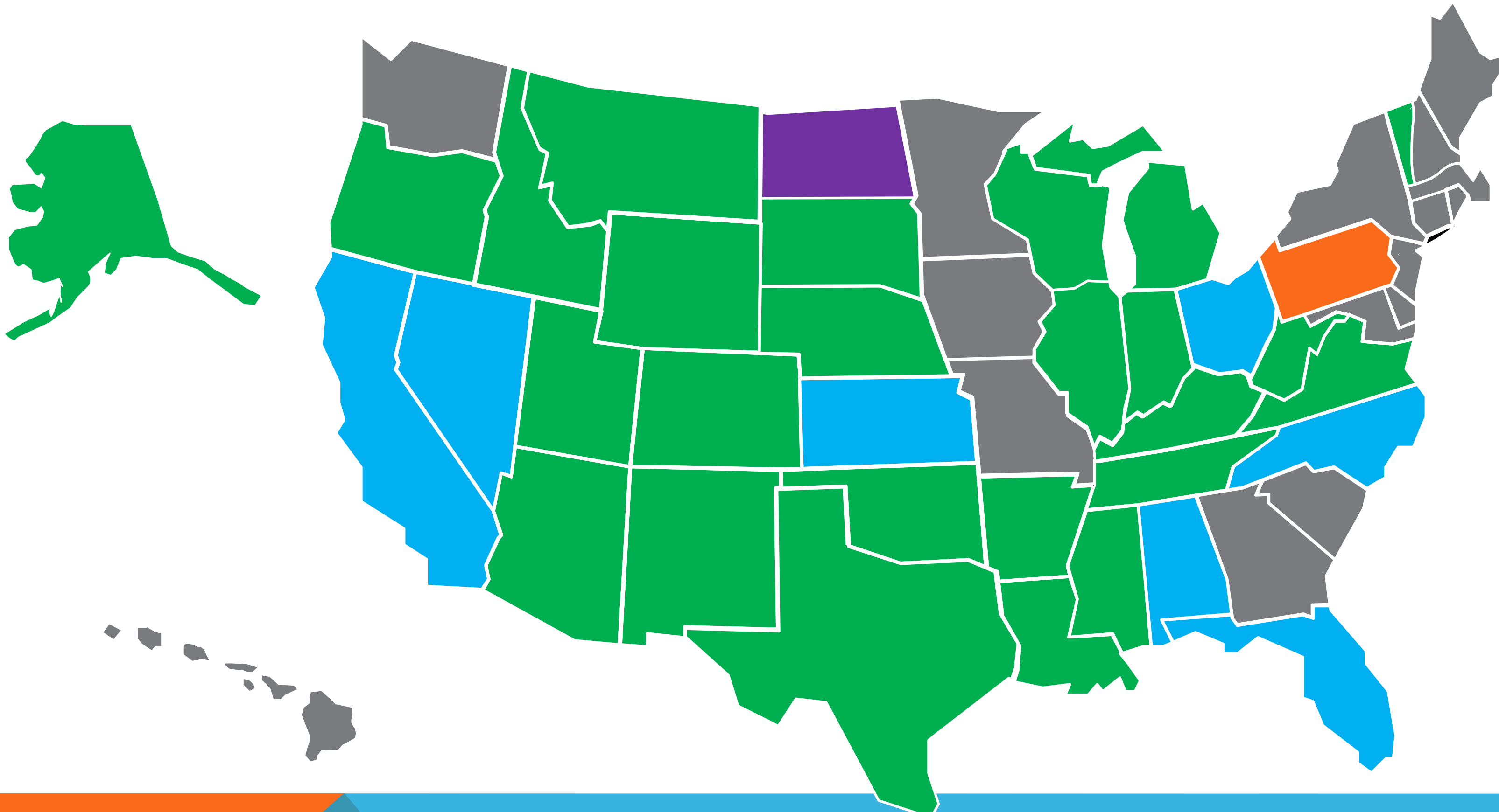
PRODUCTION AND REVENUE IN TOP STATES

State	2011-2012 average production per MMCF	Tax/fee collected 2012
1 – Texas	7.29 Million	$1.5 billion
2 – Louisiana	2.99 million	$90 million
4 – Oklahoma	1.95 million	$306 million
5 – Wyoming	2.09 million	$431 million
6 – Colorado	1.637 million	$90 million
8 – Arkansas	1.140 million*	$41 million

EFFECTIVE RATES

State	Top Rate	Effective Rate
1 – Texas	7.5% of market value	6.03%
2 – Louisiana	$0.148 per MCF	0.88%
4 – Oklahoma	7% of gross production value	4.59%
5 – Wyoming	6% of fair market value	6.05%
6 – Colorado	5% of gross income	1.58%
8 – Arkansas	5% of market value	1.35%

TYPE OF BASE – VOLUME OR VALUE?



7 states tax on volume of gas sold
25 states tax price/value of natural gas
1 state (North Dakota) is mixed volume + value

VOLUME

State	2012 production rank	Rate per MCF
California	13	$0.1406207
Florida	23	$0.345
Indiana	25	$0.03
Louisiana	2	Range $0.0104 - $0.148
Nevada	32	Up to $0.40
NC	Not ranked	Up to $0.0005
Ohio	19	$0.025
**North Dakota		$0.1143

PRICE OR VALUE OR REVENUE OR WHAT?

State	Base
Alabama, Kentucky	Gross value
Arizona, Alaska, Mississippi, Montana	Production value
Arkansas, Idaho, Michigan, Texas, Utah, Wisconsin	Market value
Colorado	Gross income
Illinois	Gross revenue
Nebraska,	Value
New Hampshire, Wyoming	Fair market value
New Mexico, South Dakota	Taxable value
North Dakota, Oregon, West Virginia	Gross value
Oklahoma	Gross production
Tennessee	Sales price

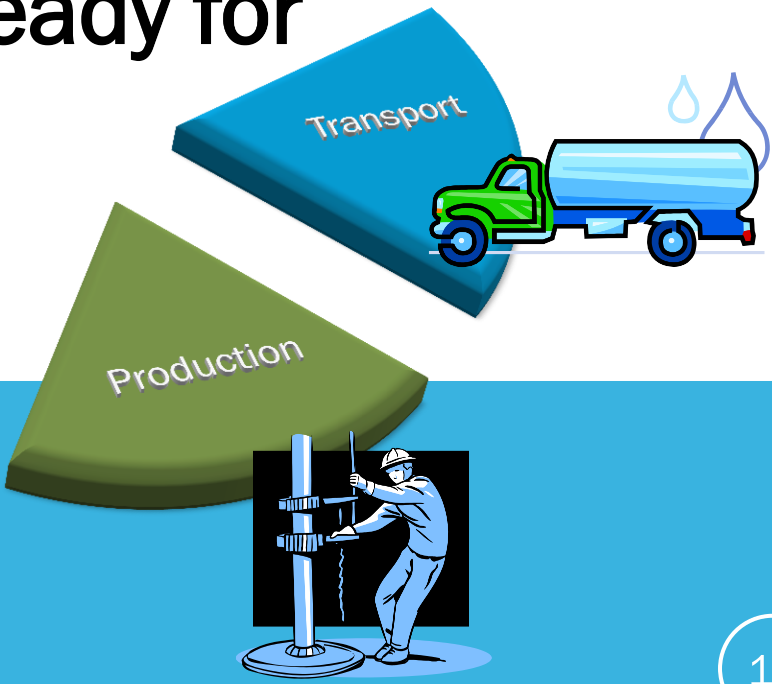
DETERMINING THE TAXABLE BASE

Alaska top rate = 25%
...but base is reduced by multiple deductions.

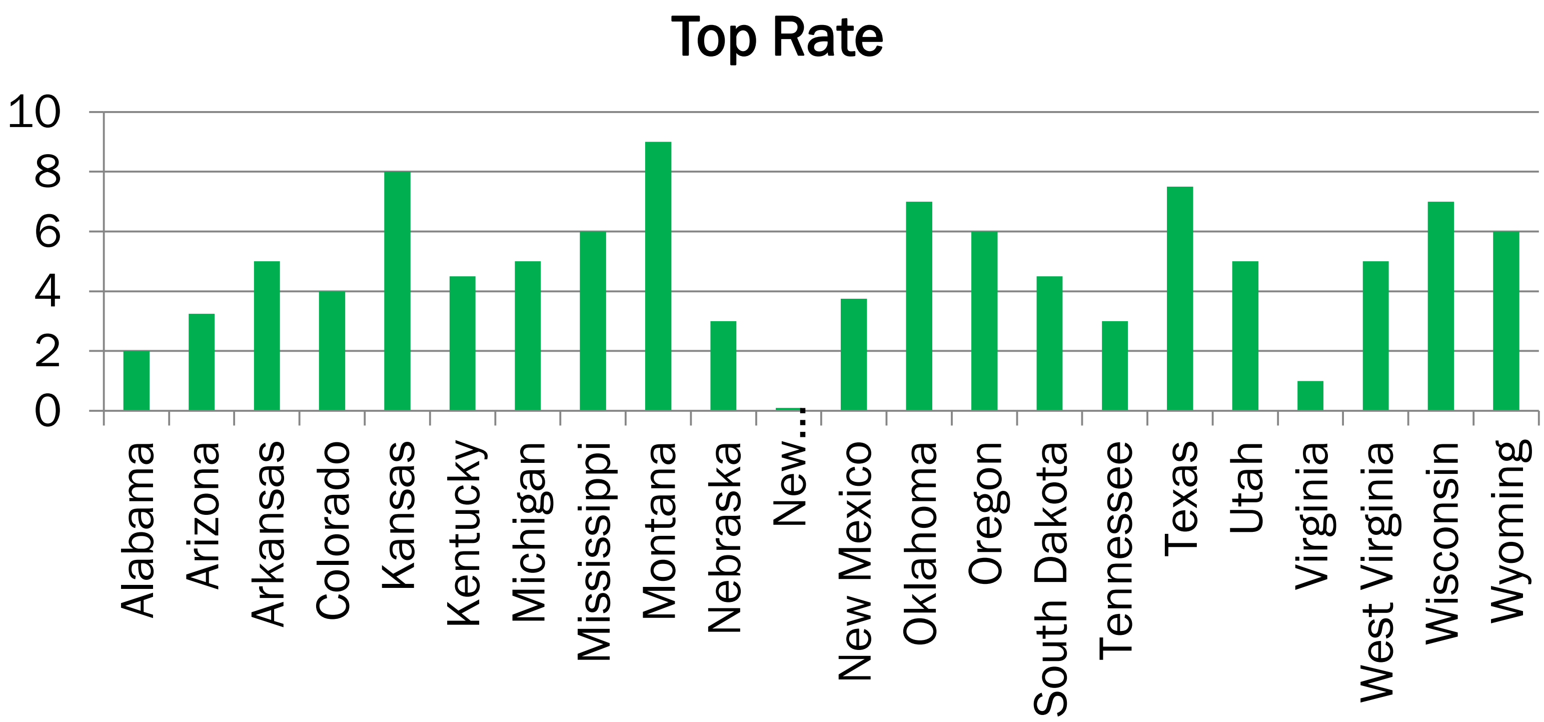
MARKETING AND TRANSPORTATION COSTS

Incentive vs tax fairness

Product price at the well head vs prepared product ready for transportation



TOP RATE FOR PRICE/VALUE



HOW IS RATE SET - VARIABLE RATE EXAMPLES

Oklahoma:

7% gas > $2.10 mcf

4% gas b/t $1.75 -$2.10 mcf

1% gas <$1.75 mcf

Colorado: Gross income

2% on income < $25K

3% on income $25K -$100K

4% on income $100k - $300K

5% on income over $300K

Utah

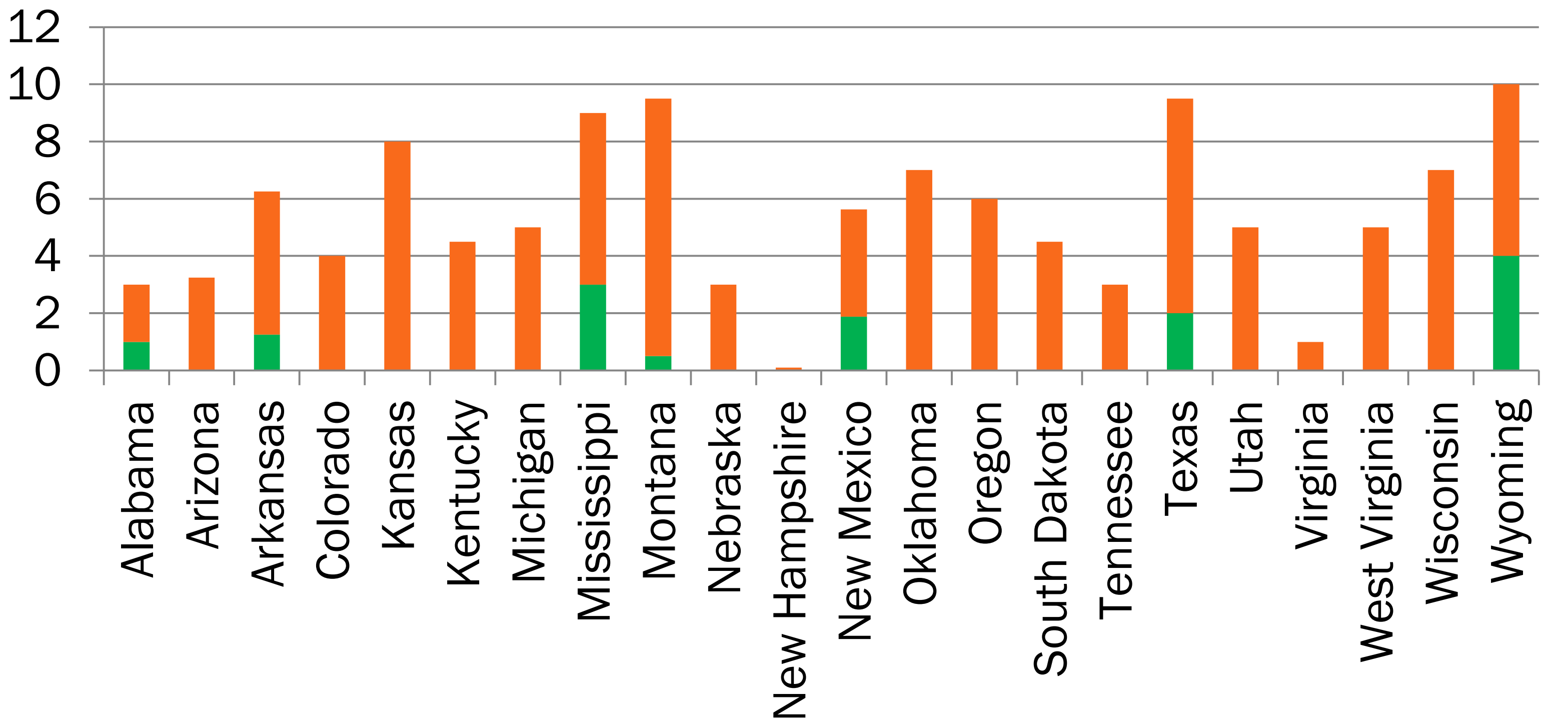
5% gas > $1.50 mcf

3% gas < $1.50 mcf

POTENTIAL SPECIAL INCENTIVE TAX RATES FOR CERTAIN WELL TYPES

- High cost wells – wells that are at least 12,500 feet in depth (from kelly to bit)
- New discovery well – produces <u>more than</u> 250 mcf of gas per day
- Marginal conventional well – produces <u>no more than</u> 250 mcf of gas per day
- Marginal high cost well – produces <u>no more than</u> 100 mcf of gas per day

TOP RATE AND INCENTIVE RATES



PROPERTY TAX

Property tax is a "visitation tax"

- **Value is decided as of January 1st each year**
  - Value will not increase until Jan 1 year following drilling allowed
  - Until county-wide reval, value will reflect schedule adopted by county in last reval

PROPERTY TAX INCENTIVES

- Full exemption for all property used to produce gas.
- Partial exemption.
- Credit against severance tax for property tax paid.
- Require reduction in property tax rate due to increase in total tax revenue resulting from value of energy minerals.

OTHER TAX ISSUES TO CONSIDER

- Impact fees?
- Sales tax on tangible personal property used in drilling, completion, production, etc.?
- Income tax on out of state drillers, etc. temporarily located in the state?
- Deductibility of intangible drilling costs?
- Deductibility of percentage depletion?

QUESTIONS