PETROLEUM TAX ADMINISTRATION IN LOUISIANA: AN OVERVIEW

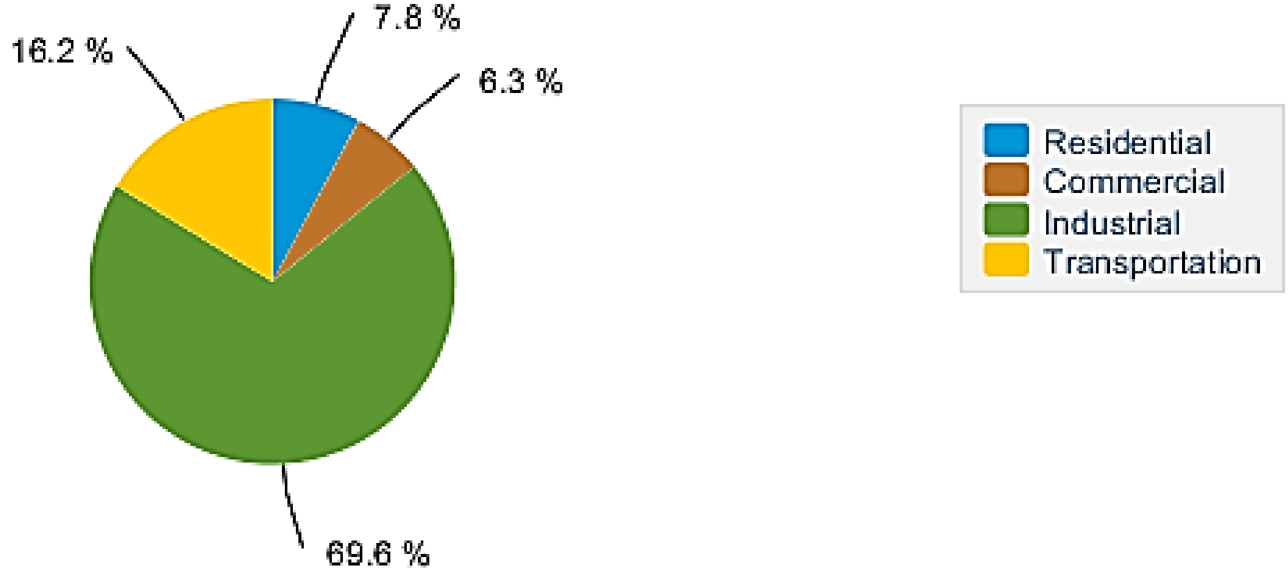
Presentation to the

LSU Petroleum Administration & Fiscal Framework Workshop

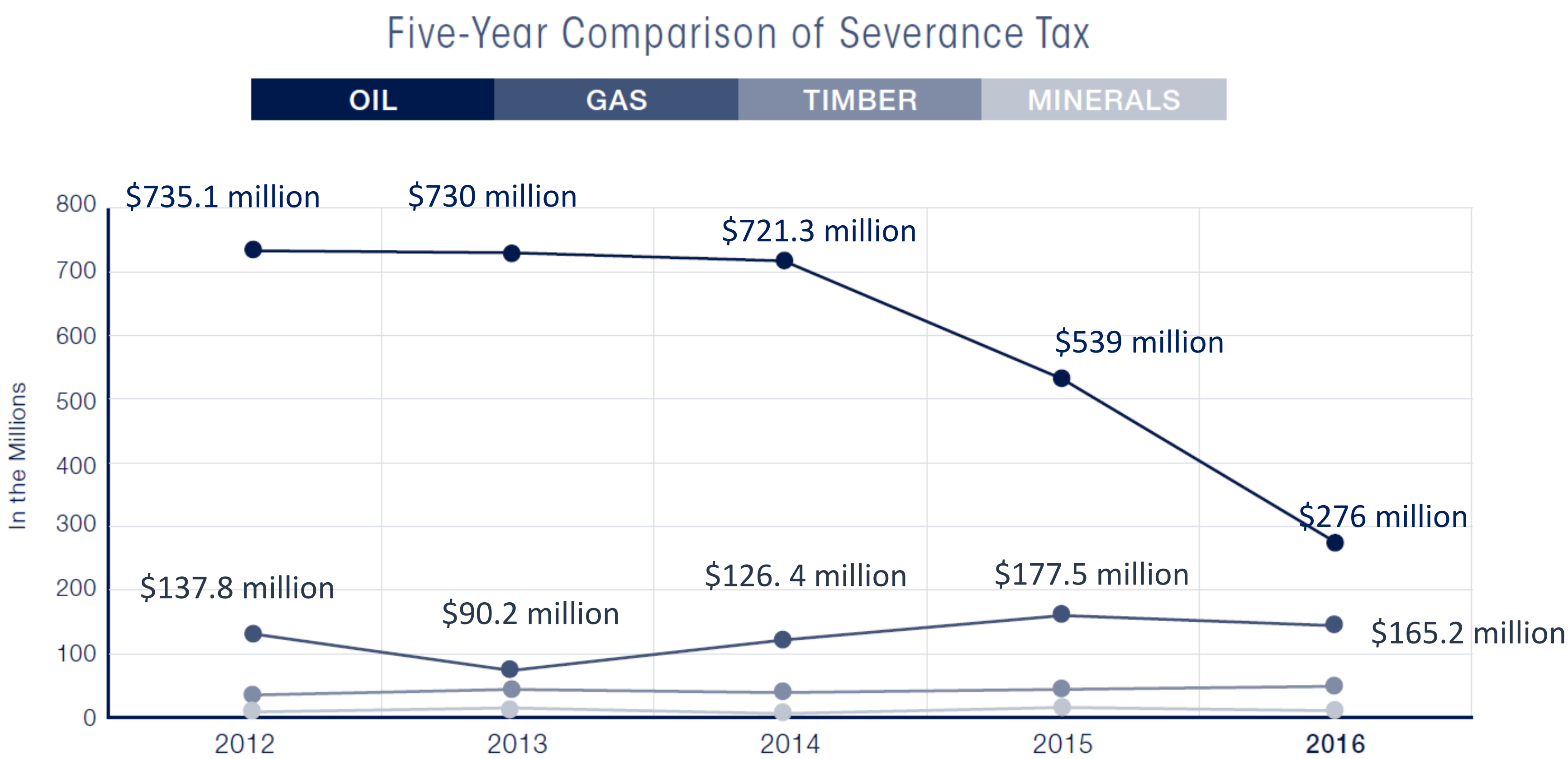
October 17, 2017

LOUISIANA DEPARTMENT OF REVENUE

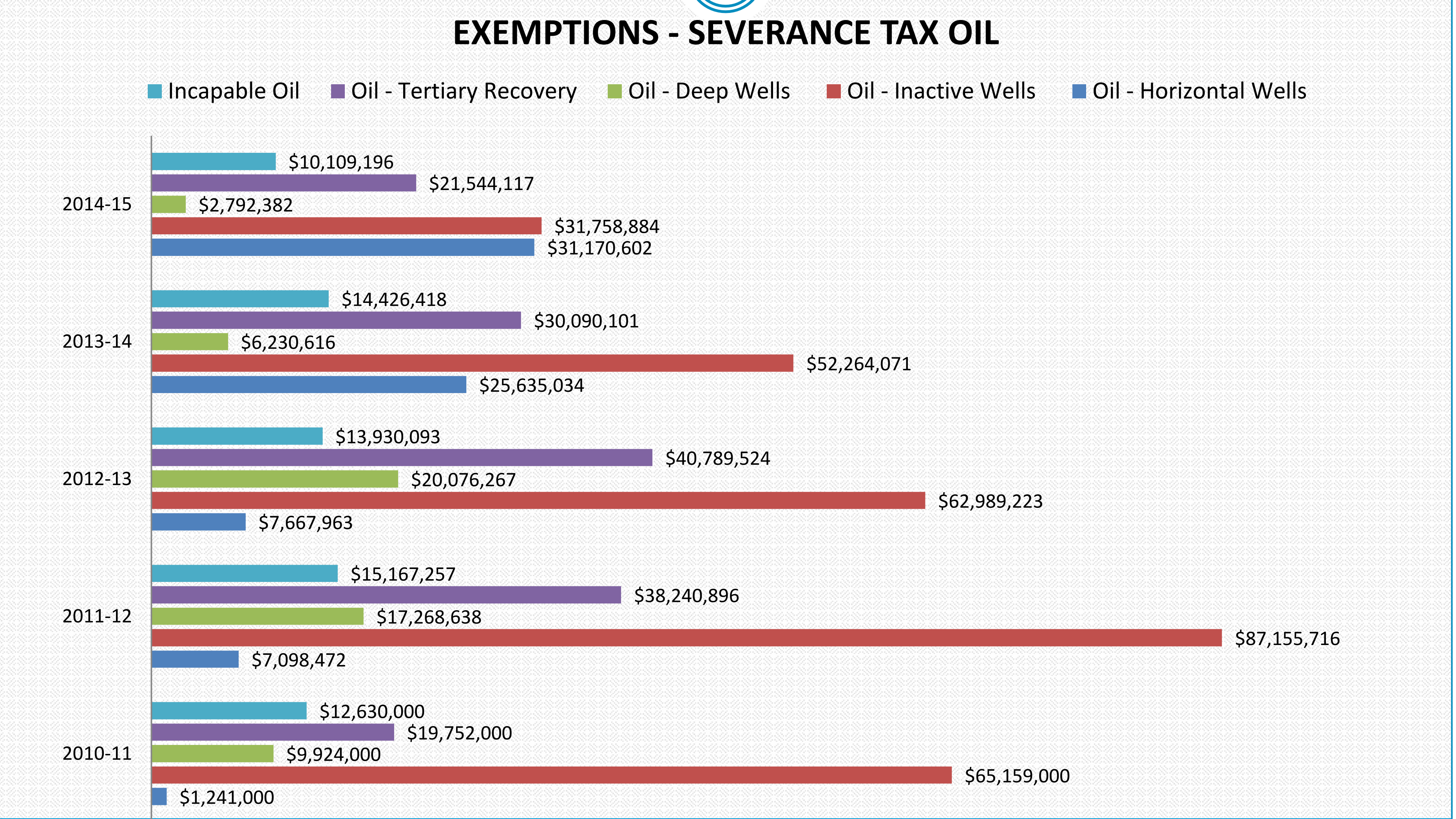
LOUISIANA ENERGY CONSUMPTION BY END-USE SECTOR, 2015



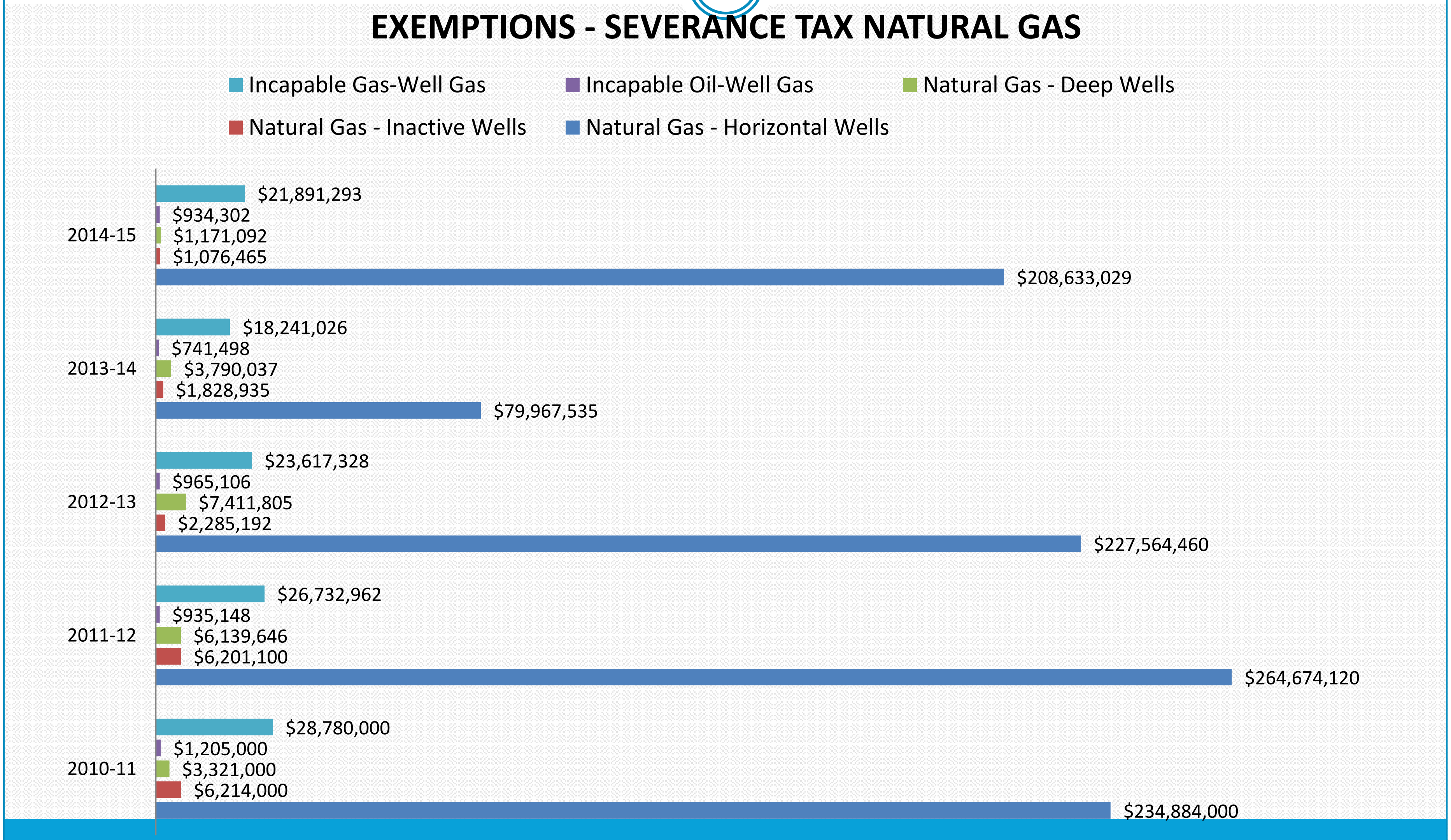
COLLECTIONS



OIL EXEMPTIONS: Horizontal Wells, Inactive Wells, Deep Wells and Incapable Wells

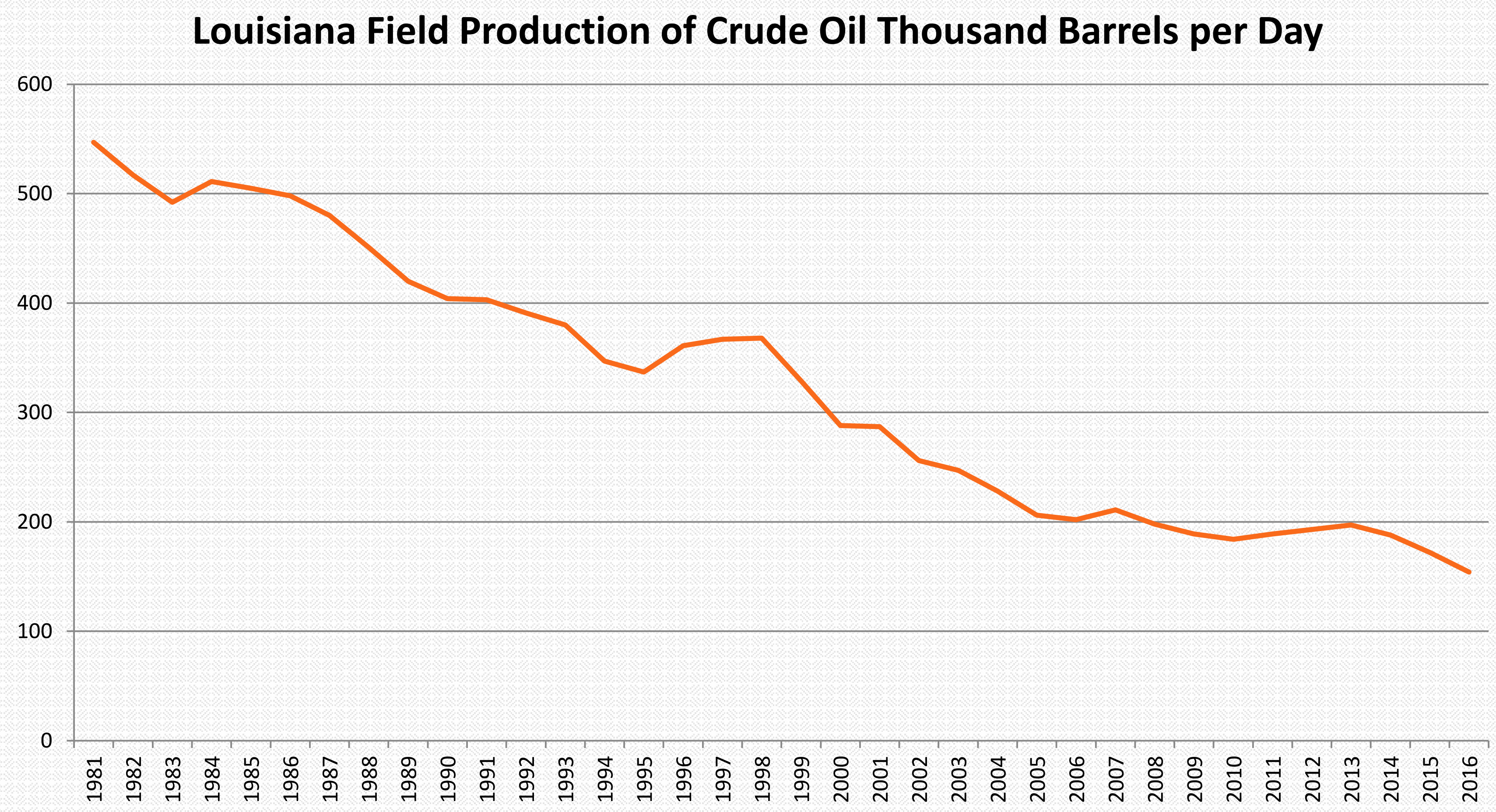


GAS EXEMPTIONS: Horizontal Wells, Inactive Wells, Deep Wells and Incapable Wells



OIL

LOUISIANA CRUDE OIL PRODUCTION



https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPLA2&f=A

PARISHES REPORTING OVER 2 MILLION BARRELS

Fiscal Year 2016

L¹	Parish	Oil Bbls	Rank
38	Plaquemines	13,752,433	1
29	Lafourche	5,805,136	2
55	Terrebonne	4,030,788	3
51	St. Mary	2,709,221	4
23	Iberia	2,458,640	5
12	Cameron	2,219,567	6

RATE

- Louisiana Revised Statute 47:633 is the state law which sets the rates for severance taxes on oil and natural gas.
- LA R.S. 47:633(7) & (8) levy a severance tax on oil at the following rates:
  - **Capable** rate: **12.5%** of value at the time and place of severance
  - **Incapable** rate: **6.25%** of value at the time and place of severance
  - **Stripper** rate: **3.125%** of value at the time and place of severance
  - **Condensate**, distillate: **12.5%** of value at the time and place of severance
  - The rate for production from an **inactive** well is **50% of the capable rate**
    - Applicable to oil produced after the well has had an "inactive" status for at least 2 years
    - Reduced rate is allowed for a 10 year period
  - The rate for production from an **orphan** well is **25% of the capable rate**
    - Applicable to oil produced after the well has had an "orphan" status for at least 60 months
    - Reduced rate is allowed for a 10 year period

HOW IS OIL VALUE CALCUATED?

- Louisiana Revised Statute 47:633(7)(a) defines "value" as the higher of:
  - the gross receipts received from the first purchaser, less charges for trucking, barging and pipeline fees; OR
  - the posted field price."
- It is important for producers to understand how a purchaser arrives at "value" in a contract.
- **Taxpayers are required to provide the documentation necessary to support the value, or contract price,** and any deductions (such as transportation and fees).

HOW IS OIL VALUE CALCUATED?

- Gross receipts includes “all things of value received directly or indirectly by the producer”
- If the producer transports the oil by his own facilities, deduction is $0.25 per barrel.
- If a third party transports the oil, the deduction is the actual amount charged.

HORIZONTAL WELLS

- Louisiana Revised Statute 47:633(7)(c)(iii) suspends or exempts severance tax on production from horizontally drilled wells, depending on the year in which the well commenced production.
- **All severance tax is suspended for a period of 24 months or until payout** for horizontally drilled wells that **commenced production between July 31, 1994, and June 30, 2015**.
- Representative Major Thibaut's Act 120 of the 2015 Regular Session modified the suspension of severance tax **for horizontally wells that commenced production on or after July 1, 2015**.
    - These wells are allowed an **exemption from severance tax for a period of 24 months or until payout** of the well is achieved.
    - LA R.S. 47:633(7)(d)(i) requires the LDR secretary to determine the oil price upon which the exemption is based according to the average New York Mercantile Exchange (NYMEX) price per barrel of crude oil per month, for the past 12 months, at the close of business on June 30th.
    - **The value of the exemption for a horizontal well is based on the NYMEX price per barrel of oil.**

HORIZONTAL WELLS

- The amount of the exemption for a horizontal well that produces oil shall be as follows:
  - 100% if the price of oil is **at or below seventy dollars** per barrel
  - 80% if the price of oil is **$70-$80** per barrel
  - 60% if the price of oil is above **$80** and at or below **$90** per barrel
  - 40% if the price of oil is above **$90** and at or below **$100** per barrel
  - 20% if the price of oil is above **$100** and at or below **$110** per barrel
- There shall be no exemption in effect for horizontally drilled wells if the price of oil exceeds $110 per barrel.

HORIZONTAL WELLS

- "Payout" occurs when gross revenue from the well, less royalties and operating costs directly attributable to the well, equals the cost of completing the well to the commencement of production, as determined by the Department of Natural Resources (DNR).
  - Operating costs are limited to those costs **directly attributable** to the operation of the exempt well, such as: direct materials, supplies, fuel, direct labor, contract labor or services, repairs, maintenance, property taxes, insurance, depreciation, and any other costs that can be directly attributed to the operation of the well.
  - Operating costs **do not include any costs that were included** in the well cost approved by the Office of Conservation.
  - **Costs** which should have been reported as initial well costs, but **which were omitted from the Application for Well Status Determination report filed with DNR's Office of Conservation cannot be included later** as an operating cost in the payout calculation.

HORIZONTAL WELLS

- The following items are **not** considered to be costs that are directly attributable to the operation of the exempt well:
  - Communication costs, including but not limited to phone & internet services
  - Lawn service, chemical weed and grass control, yard clean-up
  - Entertainment and catering costs
  - Transportation charges
  - General liabilities
  - Workers' Compensation
  - Office supplies
  - Fees charged by the LA Dept. of Conservation and DEQ permits
  - Safety training and safety class fees
  - Janitorial services
  - Appliances and appliance repairs
  - Monthly storage fees
  - Padlocks and gate locks
  - Signs
  - Rent
  - Location work on sinkholes and roads
  - Production fees
  - Expenses listed as "other"

REDUCED RATE WELLS

- In order to qualify as an **incapable** well, an oil well must:
  1. Be **classified** by DNR's Office of Conservation as an oil well which is incapable of producing an average of more than **25 barrels of oil per producing day** during a taxable month;
  2. Be **certified by LDR** as incapable on or before the 25th day of the second month following the month of production; and
  3. Produce **at least 57% salt water** per day.

REDUCED RATE WELLS

- In order to qualify as a **stripper** well, an oil well must:
  1. Be **classified** by DNR's Office of Conversation as an oil well which is incapable of producing an average of more than **10 barrels of oil per producing day** during a taxable month, and
  2. Be **certified by LDR** as incapable of producing an average of more than 10 barrels of oil per producing day on or before the 25th day of the second month following the month of production.

REDUCED RATE WELLS

- After a well has been certified for a reduced severance tax rate, **it is necessary to file continuing certification forms** on or before the 25th day of the 2nd month following the months of production.
  - It is not necessary to include stripper wells that are certified with a “B” prefix code on the continuing certification form.
  - Failure to file, or delinquent filing of, the continuation certification forms may result in certification denial for the month’s production.
  - Wells cannot be certified as both a stripper and an incapable oil well.
  - Recertification is required in any of the following circumstances:
    - the well operator changes
    - the well overproduces in the month of production
    - the well changes from one tax rate status to another tax rate status
  - All wells are subject to redetermination of their reduced rate status, based upon reports filed with LDR and DNR’s Office of Conservation.

RETURNS

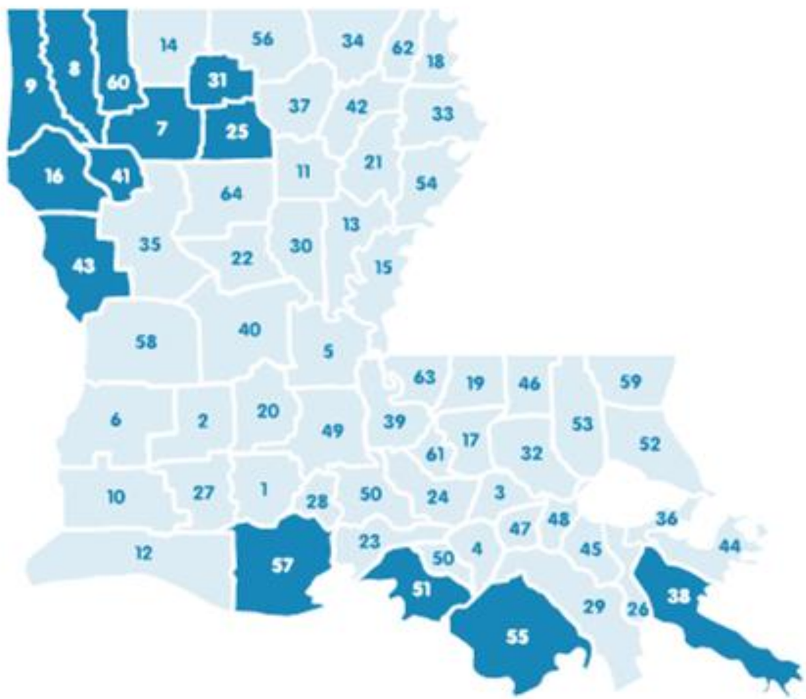
- A return must be filed by"
  - **each severer** who withholds tax from royalty payments; and
  - **each purchaser** who withholds tax from any amount due a seller or owner if the tax has not yet been paid.
- Tax returns must be filed and payment remitted on or before the twenty-fifth day of the second month following the month to which the tax is applicable.
  - The **severer must report the kind and quantity of natural resources severed**, the names of the owners, the portion owned by each, the location of each natural resource, and the places where severed.
  - The **purchaser must report the names and addresses of all sellers and the quantity and gross price paid for each natural resource**. These reports are due monthly on the same date as the tax.

COMMON CAUSES FOR AUDIT ADJUSTMENTS

- **Discrepancies** in volumes reported to LDR vs. DNR
- Unreported barrels
- Bonuses, premiums and transportation reimbursements that are not reflected in the reported value
- Non-arms-length transactions
- **Excessive claims**:
  - Transportation deductions
  - Federal government royalties

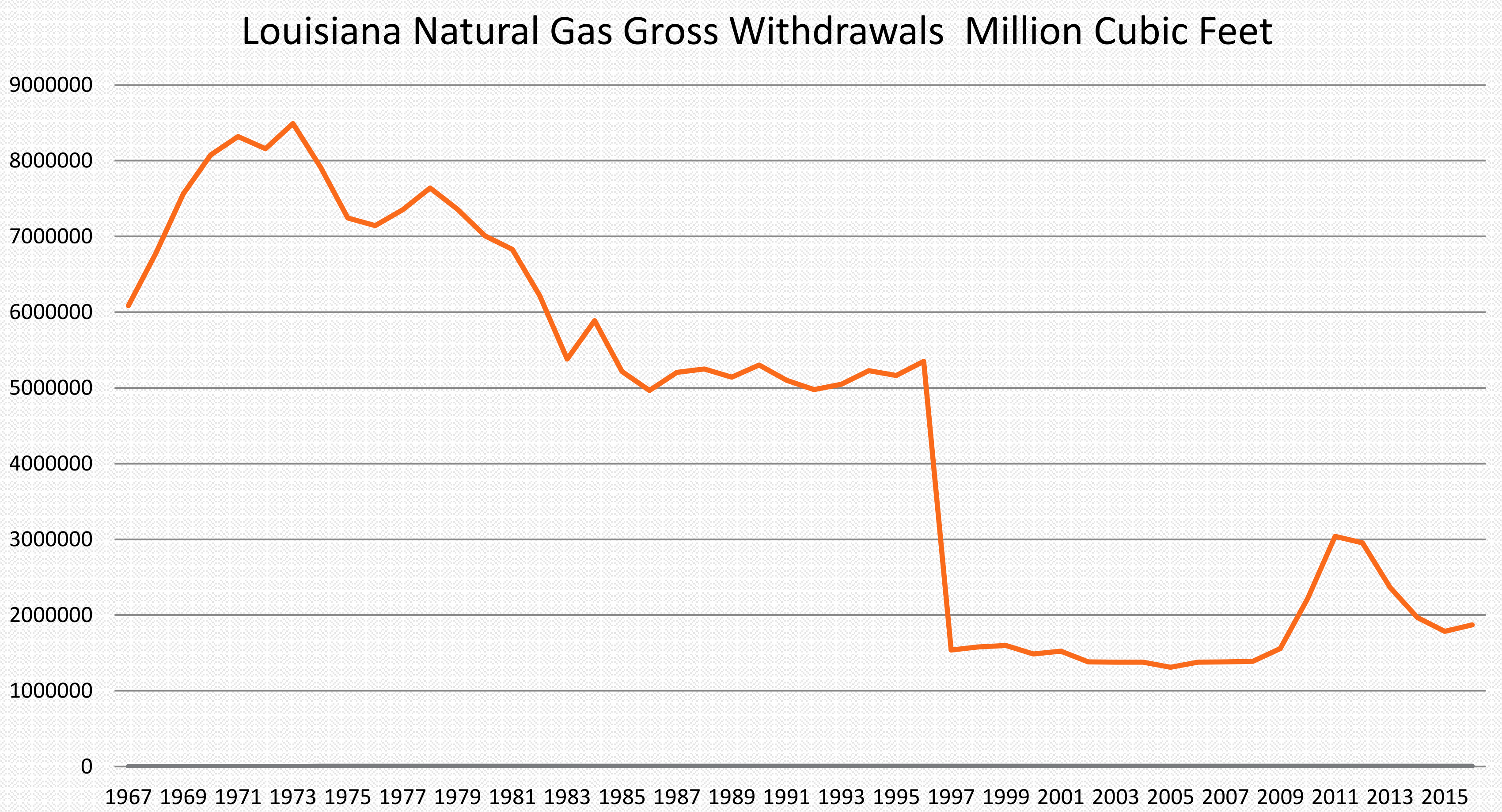
GAS

PARISHES PRODUCING OVER 25 MILLION MCFs



L[1]	Parish	Gas MCFs	Rank
16	DeSoto	291,874,738	1
41	Red River	144,870,710	2
31	Lincoln	137,924,648	3
9	Caddo	96,025,323	4
8	Bossier	86,288,060	5
7	Bienville	52,948,124	6
51	St. Mary	47,112,642	7
57	Vermillion	43,959,240	8
38	Plaquemines	28,977,963	9
55	Terrebonne	28,559,527	10
43	Sabine	28,200,497	11
60	Webster	25,571,808	12
25	Jackson	25,326,280	13

LOUISIANA NATURAL GAS PRODUCTION



LOUISIANA NATURAL GAS PRODUCTION

- Natural Gas Infrastructure Overview:
  - Gas Wells: 19,683 (**4%** of U.S. total)
  - Processing Plants: 54 (**10%** of U.S. total)
  - Storage Fields: 21 (**5%** of U.S. total)
  - Interstate Pipelines: 44,640 Miles (**9%** of U.S. total)
  - Local Distribution Companies: 108 (**6%** of U.S. total)

https://energy.gov/sites/prod/files/2016/09/f33/LA_Energy%20Sector%20Risk%20Profile.pdf

LOUISIANA NATURAL GAS PRODUCTION

- Louisiana is #5 in the United States in natural gas production (non-OCS)
- The Haynesville Shale was a leader in shale and fracking innovation in the United States
  - The “Haynesville Boom” more than doubled Louisiana’s natural gas production from 2006 to 2011
- Louisiana is the #1 per capita energy user in the US, using 6% of all natural gas (including refineries and generation)

https://energy.gov/sites/prod/files/2016/09/f33/LA_Energy%20Sector%20Risk%20Profile.pdf

RATE

- LA R.S. 47:633(9)(a)(ii) and (d) requires the LDR secretary to annually adjust the severance tax rate on natural gas produced from capable wells.
  - The rate equals 7 cents per thousand cubic feet (MCF), **multiplied by** the gas base rate adjustment for the fiscal year, as determined by the DNR secretary.
  - The natural **gas severance tax rate for the 2016-2017 fiscal year** was **9.8 cents per MCF**.
  - The natural **gas severance tax rate for the 2017-2018 fiscal year** has been set at **11.1 cents per MCF**.
- Rate for low pressure wells—3 cents per MCF
- Rate for incapable wells—1.3 cents per MCF

RATE

- The rate for production from an **inactive** well is **50% of the capable rate**
  - Applicable to gas produced after the well has had an "inactive" status for at least 2 years
  - Reduced rate is allowed for a 10 year period
- The rate for production from an **orphan well** is **25% of the capable rate**
  - Applicable to gas produced after the well has had an "orphan" status for at least 60 months
  - Reduced rate is allowed for a 10 year period

HORIZONTAL WELLS

- Louisiana Revised Statute 47:633(7)(c)(iii) suspends or exempts severance tax on production from horizontally drilled wells, depending on the year in which the well commenced production.
- For horizontally drilled wells that **commenced production between July 31, 1994, and June 30, 2015**:
  - **All severance tax is suspended for a period of 24 months or until payout**
- For horizontally drilled wells that **commenced production on or after July 1, 2015:**
  - The well is allowed an **exemption from severance tax for a period of 24 months or until payout** of the well is achieved.
  - LA R.S. 47:633(7)(d)(ii) requires the LDR secretary to determine the natural gas price upon which the exemption is based according to the average New York Mercantile Exchange (NYMEX) price per million BTU per month on the close of business June 30th for the prior 12 months.
  - **The value of the exemption for a horizontal gas well is based on the NYMEX price per million BTU.**

HORIZONTAL WELLS

- The amount of the exemption for a horizontal well that produces natural gas shall be as follows:
  - 100% if the price of natural gas is at or below $4.50 per million BTU
  - 80% if the price of natural gas is above $4.50 and at or below $5.50 per million BTU
  - 60% if the price of natural gas is above $5.50 and at or below $6.00 per million BTU
  - 40% if the price of natural gas is above $6.00 and at or below $6.50 per million BTU
  - 20% if the price of natural gas is above $6.50 and at or below $7.00 per million BTU
- There shall be no exemption in effect for horizontally drilled wells if the price of gas exceeds $7.00 per million BTU.

REDUCED RATE WELLS

- In order to qualify as an **incapable** gas well, the well must be **classified** by DNR's Office of Conservation as a gas well which is incapable of producing more than **250,000 cubic feet of gas per day** during a taxable month.

REDUCED RATE WELLS

- In the case of gas produced from an oil well:
  - in order to qualify as a **low pressure well**, the well must be designated by DNR's Office of Conservation to have a **wellhead pressure of 50 pounds per square inch gauge or less** under operating conditions; or
  - In the case of gas rising in a vaporous state through the annular space between the casing and tubing of the oil well and released through lines connected with the casinghead gas, DNR's Office of Conservation must have determined that the well has **a casinghead of 50 pounds per square inch gauge or less** under operating conditions.

REDUCED RATE WELLS

- To receive the reduced severance tax rate on natural gas or casinghead gas production, an application must be filed with LDR **on or before the 25th day** of the second month following the month in which the production occurs.
- After a well has been certified for the reduced tax rate, it is necessary to file **continuing certification forms** on or before the 25th day of the second month following the month of production.
- It is not necessary to include incapable gas wells that are certified with an "F" prefix code on the continuing certification forms.
- **Failure to file or delinquent filing** of the continuing certification forms **may result in certification denial for the month's production**.

REDUCED RATE WELLS

- A well cannot be certified as both an incapable oil well and an incapable gas well.
- If the well changes from one tax rate status to another tax rate status, a new certification is required.
- **Recertification is required in any of the following circumstances**:
  - the well operator changes
  - the well overproduces in the month of production
  - the well changes from one tax rate status to another tax rate status

RETURNS

- A return must be filed by:
  - each severer who withholds tax from royalty payments; and
  - each purchaser who withholds tax from any amount due a seller or owner if the tax has not yet been paid.
- Tax returns must be filed and payment remitted on or before the twenty-fifth day of the second month following the month to which the tax is applicable.
  - The severer must report the kind and quantity of natural resources severed, the names of the owners, the portion owned by each, the location of each natural resource, and the places where severed.
  - The purchaser must report the names and addresses of all sellers and the quantity and gross price paid for each natural resource. These reports are due monthly on the same date as the tax.

COMMON CAUSES FOR AUDIT ADJUSTMENTS

- **Underreporting** of taxable MCF's
- **Misunderstanding** amongst partners regarding the method of payment (ex: operator pays his own share and partners think he is paying for them, etc.)
- Plant fuel, shrinkage, and residue not reported as part of taxable volume
- Allocation procedure not correctly followed or followed in error
- Severance tax paid after processing, when sale occurred in the field
- Severance tax nonpayment on the production of natural gas liquids
- On the exclusion from severance tax for field use gas: plant use gas does not apply to the exclusion.
- Reporting wells at a reduced rate on returns for uncertified wells.

Audit Considerations

AUDIT CONSIDERATIONS

- Taxpayers are asked to retain the following records, which are requested when audit appointments are scheduled:
- **OIL**
  - Oil sale contracts and/or marketing agreements
  - Invoices to purchasers
  - Transportation contracts
  - Purchaser oil run statements and/or accounting records of oil sales
  - Working interest ownership percentage(s) of Take in Kind volumes
  - Well division orders for any properties with a U.S. government royalty interest
  - Records related to payout computation on deep and horizontal wells, if applicable
  - **Taxpayers may be asked for additional documentation such as production and sales allocation and inventory receipt statements.**

AUDIT CONSIDERATIONS

- Taxpayers are asked to retain the following records, which are requested when audit appointments are scheduled:
- **GAS**
  - Purchaser gas settlement statements-purchaser meter statements or transporter meter statements
  - Louisiana Department of Natural Resources plant reports (R-6), if applicable
  - Plant Gas Processing Statements, if applicable
  - Working interest ownership percentage(s) of Take In Kind volumes
  - Well division order for any properties with a U.S. government royalty interest
  - Records related to payout computation on deep and horizontal wells, if applicable
  - **Taxpayers may be asked for additional documentation such as gas delivered, meter readings, field and or plant sketches, gas allocation statements, and gas plant gas allocation statements.**

AUDIT CONSIDERATIONS

- LDR auditors and agents strive to make the audit process as efficient as possible. In order to attain the least burdensome assessment, we ask that taxpayers observe the following requests:
  - **Taxpayers are asked to include the field/lease/well numbers in their records, in addition to well names**. This allows us to recognize the correlation between the records and LDR returns.
  - Taxpayers are also asked to:
    - reference exempt wells (inactive or horizontally drilled) by well number, instead of lease number, on the LDR return
    - have records and a contact person readily available.

AUDIT PROGRAMS AT LDR

- Taxpayer Compliance
- Field Audit Excise
  - Revenue Tax Specialists -production and reduced rate well compliance reviews as limited scope audits.
  - Auditors -full scope audits
  - Tax Specialists and Revenue Tax Auditors work together to ensure no duplication of assessments

OTHER STATE TAXES/FEES PAID BY UPSTREAM OPERATIONS

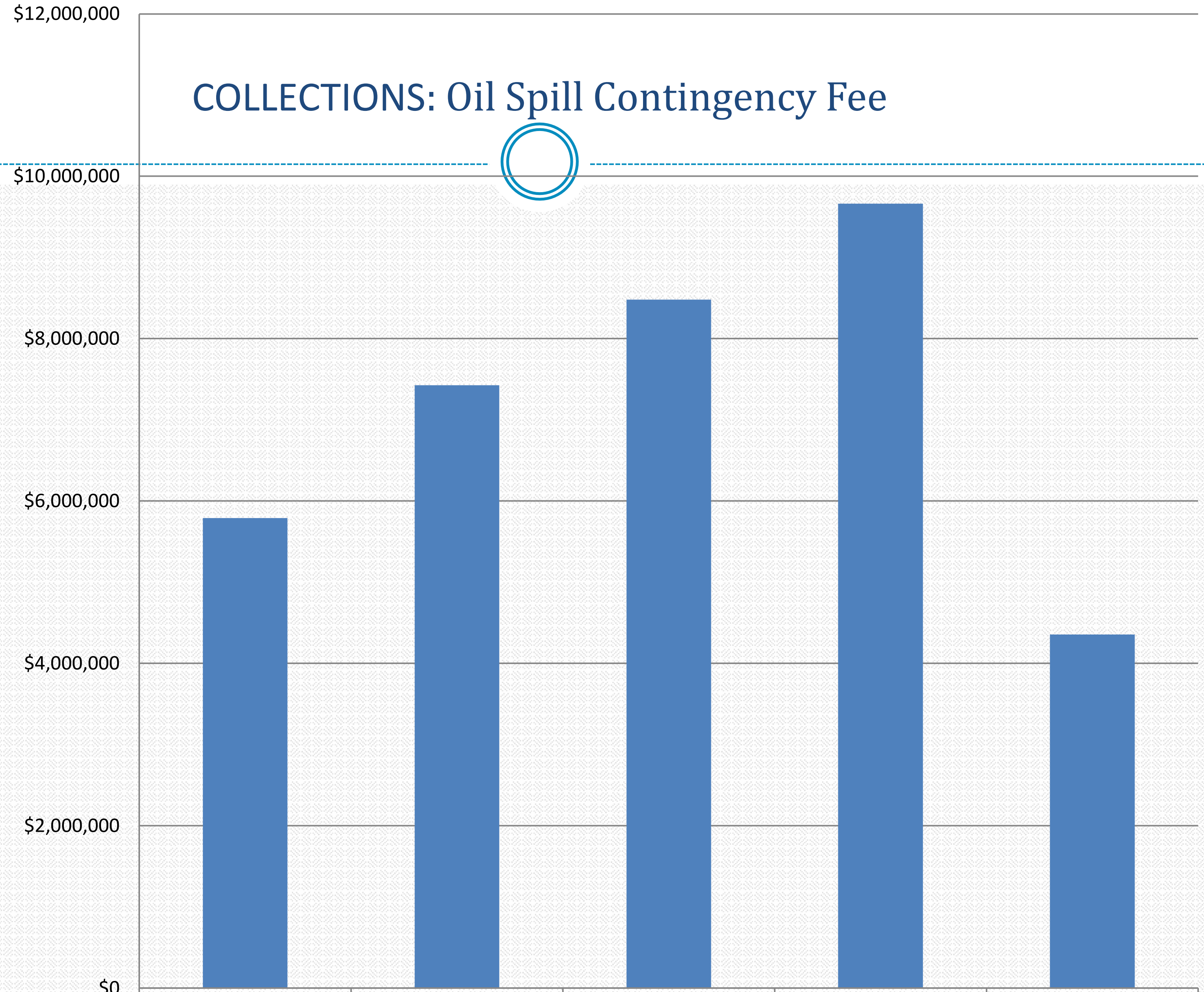
- Corporate Income or Franchise tax
- Oil Spill Contingency Fee
- Oilfield Site Restoration Fee
- Inspection and Supervision Fee
- Sales taxes for materials/supplies
- Payroll taxes

Oil Spill Contingency Fee

OIL SPILL CONTINGENCY FEE

- This fee is imposed upon every person owning crude oil in a vessel at the time such crude oil is transferred to or from a vessel at a marine terminal within the state of Louisiana.
  - Payments of the fee are credited to the Oil Spill Contingency Fund. The purpose of the Fund is to implement the protection, conservation, and replenishment of the state's natural resources by preventing unauthorized discharges of oil.
  - Rate: One-quarter of one cent per barrel per person owning crude oil received by a refinery for storage or processing. *However, state law contains triggers for the rate to increase to one-half cent per barrel.*
    - If the Fund balance drops below $5 million AND an unauthorized discharge of oil in excess of 100,000 gallons has occurred within the previous 12 months; or
    - If the balance in the fund is below $5 million due to expenditures from the Fund (in accordance with state law)
  - The last owner of the crude oil prior to its transfer to the refinery or storage facility is the person who must pay the fee.

COLLECTIONS: Oil Spill Contingency Fee



	2010-11	2011-12	2012-13	2013-14	2014-15
TOTAL NET COLLECTIONS	$5,788,555	$7,427,333	$8,479,303	$9,661,381	$4,355,134

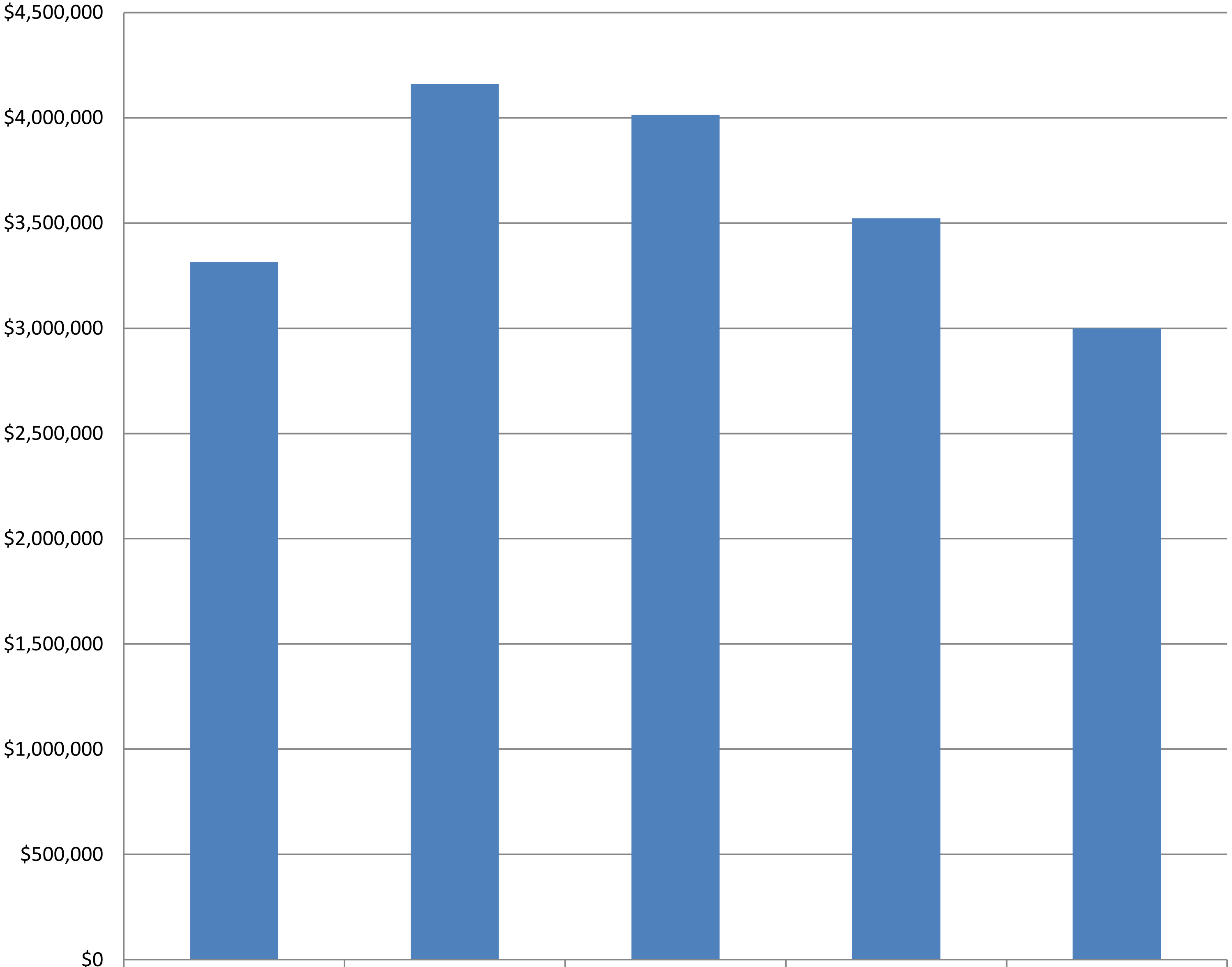
OILFIELD SITE RESTORATION FEE

OILFIELD SITE RESTORATION FEE

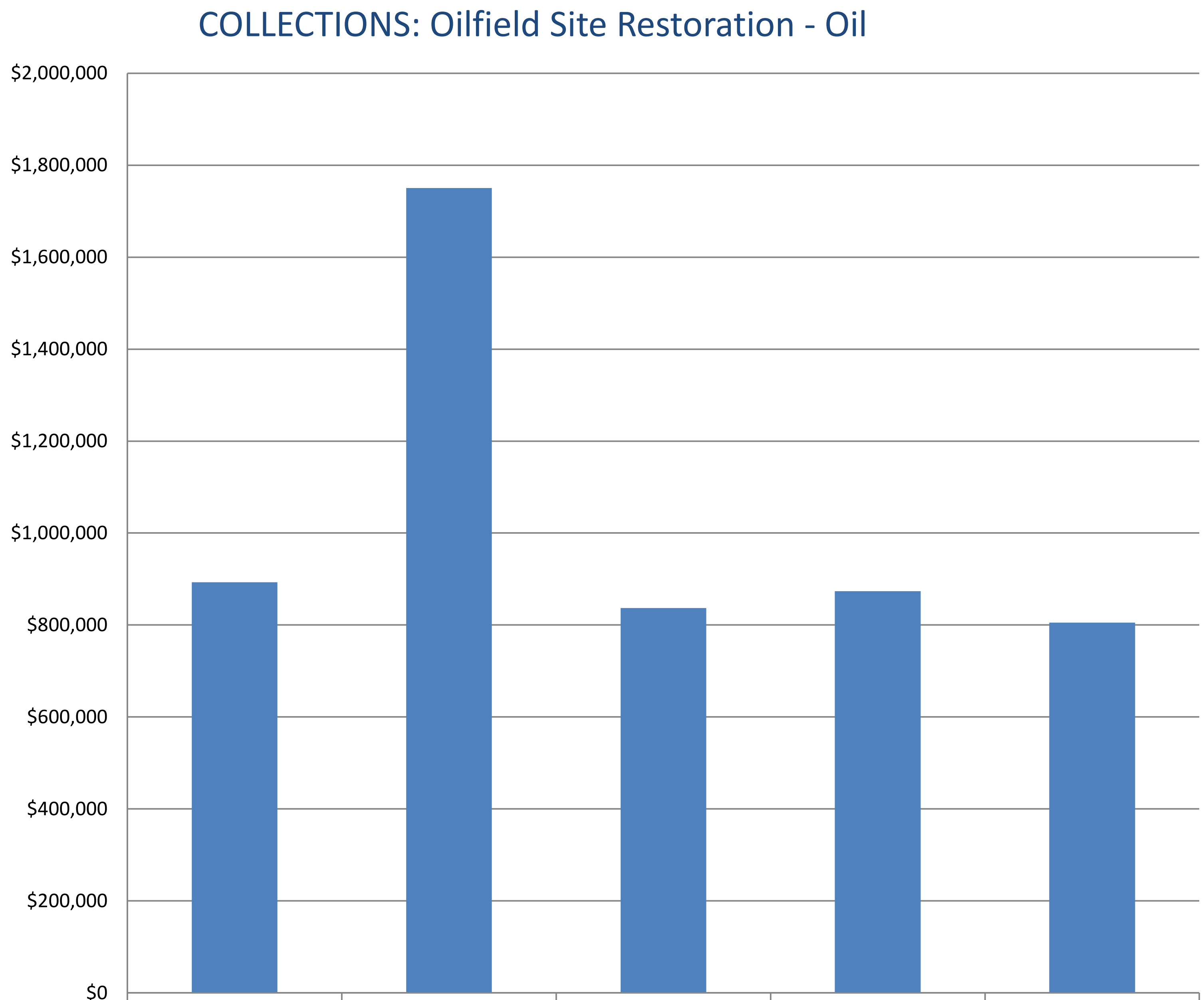
- This fee is imposed upon gas produced from producing wells in this state at the rate of three-tenths of one cent for each thousand cubic feet
- The site restoration fee on crude oil and condensate is imposed as follows:
  - Full rate production:
    - One and one-half cents per barrel on crude oil and condensate if the price of oil is at or below $60 per barrel*
    - Three cents per barrel on crude oil and condensate if the price of oil is at or below $90 per barrel*
    - Four and one-half cents per barrel on crude oil and condensate if the price of oil is above $90 per barrel*
  - The fee for reduced rate production (stripper and incapable wells) is reduced in the same proportion as the rate for severance tax is reduced (R.S. 47:633)

*Barrel price based upon the average New York Mercantile Exchange Price per barrel of crude oil per month on the close of business on June 30th for the prior twelve months

COLLECTIONS: Oilfield Site Restoration - Gas



	2010-11	2011-12	2012-13	2013-14	2014-15
TOTAL NET COLLECTIONS	$3,314,098	$4,159,761	$4,014,807	$3,521,603	$2,999,160



	2010-11	2011-12	2012-13	2013-14	2014-15
TOTAL NET COLLECTIONS	$893,087	$1,750,196	$836,969	$873,431	$805,072

Questions?