

Energy Tax News

Alberta's New Royalty Framework

—Government takes larger share and simplifies rules

On October 25, 2007, Premier Ed Stelmach announced Alberta's New Royalty Framework. The Framework changes the current royalty and income tax system in Alberta, adopting some, but not all, of the recommendations of the Alberta Royalty Review Panel (the "Panel"), whose report was issued on September 18, 2007. The changes, to be effective January 1, 2009, will have a significant effect on the oil and gas industry in Alberta and, in particular, on the economics of major oil sands projects.

Major Changes and Features

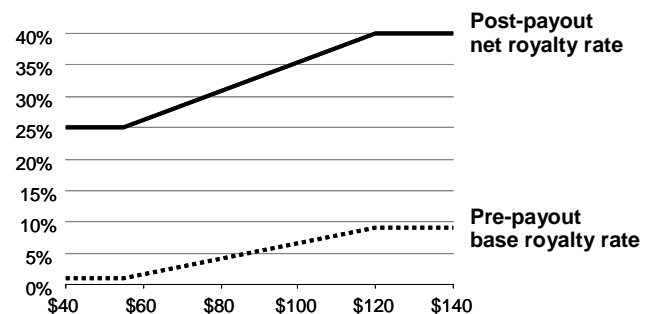
The Framework contains the following major changes and features:

Oil Sands

The base royalty rate will start at 1%, increasing for every dollar the West Texas Intermediate (WTI) oil price is above CAD\$55 per barrel, to a maximum of 9% when the WTI oil price is \$120 per barrel for the "pre-payout" period of an oil sands project. The base royalty will not be payable after the payout period.

The net revenue royalty will start at 25%, increasing for every dollar the WTI oil price is above \$55 per barrel, to a maximum of 40% when the WTI oil price is \$120 or higher. The Premier believes that the current 25% rate is unnecessarily low and that the new rate, which factors in price sensitivity, provides a much fairer return to Albertans, as owners of the oil sands resources.

		Pre-payout base royalty rate	Post-payout net royalty rate
West Texas Intermediate (WTI) oil price (CAD)	\$55	1.00%	25.00%
	\$65	2.23%	27.31%
	\$75	3.46%	29.62%
	\$85	4.69%	31.92%
	\$95	5.92%	34.23%
	\$105	7.15%	36.54%
	\$115	8.38%	38.85%
	≥ \$120	9.00%	40.00%



The Framework rejected a new tax (the Oil Sands Severance Tax, or "OSST") recommended by the Panel.

The Framework states that the government will adopt a permanent generic "bitumen valuation methodology" by June 30, 2008, that will apply to non-arm's length sales of bitumen.

The Framework has rejected the Panel's proposed Upgrader Royalty Credit of 5% of eligible capital expenditures on additional upgrading capacity in Alberta. Instead, to encourage construction of upgraders in Alberta, the government is

considering options such as:

- taking bitumen in kind rather than cash to supply to potential upgraders and refineries in Alberta;
- adjusting pipeline tolls that may have the effect of subsidizing bitumen exports; and
- expediting regulatory approvals for projects with upgraders.

The government will work with Syncrude and Suncor over the next 90 days to agree on a transition plan, and, if no agreement is reached, will take other measures to ensure a level playing field for all industry stakeholders.

Conventional Oil

The Framework will eliminate specialty royalty programs and the “old” and “new” tiers. Royalties will be calculated monthly by a single sliding-rate formula that will factor in oil price and well production.

The current Enhanced Oil Recovery and Innovative Energy Programs will be retained to encourage research and additional oil recovery.

The current maximums of 30% and 35% for the “old” and “new” tiers will be replaced by new royalty rates from 0% to 50%, and rate caps will be raised to \$120 per barrel.

Natural Gas

The current royalty rates, which range from 5% to 35%, will be replaced by a range of 5% to 50%, with a rate cap at CAD\$16.59/GJ (gigajoule).

The “old” and “new” tiers will be eliminated, but the Otherwise Flared Solution Gas Royalty (OFSG) Waiver Program will be retained and extended to bitumen wells. The OFSG program is intended to improve air quality through solution gas conservation.

The current Deep Gas Drilling Program will be retained and revamped and will lower royalty rates over a wider price range for less productive wells.

Royalties for pentanes will be increased to 40% from 22% to 50% for “old” tiers and 22% to 35% for “new” tiers. The royalties for butane and propane will be set at 30% as opposed to the current range of 15% to 30%.

Other issues

Under the Framework, no “grandfathering” will be allowed for any of the changes to ensure fair treatment to all participants.

The current Freehold Mineral Rights Taxes cover the province’s cost of administering the regulatory system and will be reviewed to ensure that it is achieving its purpose.

Implications of the Report

If the entire Framework is implemented, the Alberta government expects to receive an additional \$1.4 billion in royalties in 2010, an increase of approximately 20%, and it will affect every company in the energy sector in Alberta, not just the oil sands players.

Because provincial royalties are fully deductible for federal income tax purposes, the new regime would result in a significant decline in federal income tax revenues from the oil sector. This would result in a situation similar to the early 1970s, when increases in provincial royalty rates led to the introduction of the federal resource allowance system, which was designed to mitigate the loss of federal revenues from high provincial royalty rates. Ironically, the phase-out of the resource allowance system became fully effective on January 1, 2007. This raises the question of how the federal government will react.

While the Alberta government believes that the new regime will not have any immediate negative effect on Alberta’s economy, the oil and gas industry has voiced serious concerns. As companies continue to analyze the implications of the changes, investment decisions with respect to existing and future oil and gas projects in Alberta are likely to be affected.

For help understanding the implications of the new rules, please contact any of the individuals listed below:

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