OKLAHOMA TAX COMMISSION

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July 9, 2003

Our File No. LR-03-123, (Gross Production Tax) Incentive information.

Dear

This letter is in response to your request for information regarding Oklahoma's oil and gas tax incentives.

I have reviewed the copy of information on Oklahoma incentives from the 2002 edition of "Investments in Energy Security" that you provided. In lieu of completing your survey form, I have re-drafted your report and amended certain content to ensure accuracy and reflect statutory changes.

OKLAHOMA

Reduction in the State's Gross Production Tax on Oil

The gross production tax rate levied on oil was changed from a fixed rate of 7% to a variable rate of either 7%, 4% or 1%.

Effective with the January 1999 production month, the gross production tax rate on oil is as follows:

- If the average price of Oklahoma oil as determined by the Tax Commission equals or exceeds seventeen dollars ($17.00) per barrel, the tax shall be levied at seven percent (7%).
- If the average price of Oklahoma oil as determined by the Tax Commission is less than seventeen dollars ($17.00) but is equal to or exceeds fourteen dollars ($14.00) per barrel, the tax shall be levied at four percent (4%).
- If the average price of Oklahoma oil as determined by the Tax Commission is less than fourteen dollars ($14.00) per barrel, the tax shall be levied at one percent (1%).

Citation: Okla. Stat. Tit. 68 § 1001 (B) (2002)
Effective date: January 1, 1999, through June 30, 2004.

Reduction in the state's Gross Production Tax on Gas

The gross production tax rate levied on gas was changed from a fixed rate of 7% to a variable rate of either 7%, 4% or 1%.

Effective with the July 2002 production month, the gross production tax rate on gas is as follows:

- If the average price of Oklahoma gas as determined by the Tax Commission equals or exceeds two dollars and ten cents ($2.10) per mcf, the tax shall be levied at seven percent (7%).
- If the average price of Oklahoma gas as determined by the Tax Commission is less than two dollars and ten cents ($2.10) but is equal to or exceeds one dollar and seventy-five cents ($1.75) per mcf, the tax shall be levied at four percent (4%).
- If the average price of Oklahoma gas as determined by the Tax Commission is less than one dollar and seventy-five cents ($1.75) per mcf, the tax shall be levied at one percent (1%).

Citation: Okla. Stat. Tit. 68, § 1001 (B) (2002)
Effective date: July 1, 2002, through June 30, 2007.

Effective July 1, 2003, the average price as computed by the Oklahoma Tax Commission for both oil and gas shall be used to determine the applicable tax rate for the second month following production.

Citation: Okla. Stat. tit. 68. § 1001 (B) (3) (2003)

Tax Exemption for Secondary Recovery Project

The incremental production from approved secondary oil recovery projects begun on or after July 1, 1988, and before July 1, 2000, is eligible for an exemption of gross production tax for a period of ten (10) years or expire upon project payback, whichever occurs first.

Citation: Okla. Stat. Tit. 68, § 1001 (D) (1) (2) (2002)
Effective dates: July 1, 1988, through June 30, 2000.
Goal: To encourage operators to increase ultimate recovery by employment of secondary recovery techniques.

Tax Exemption for Secondary Recovery Properties

The incremental production from approved secondary recovery properties approved or having an initial beginning date on or after July 1, 2000, and prior to July 1, 2006, is exempt from gross production tax for a period of five (5) years or ending upon termination of the secondary recovery process. The operator of the unit is not required to submit capital expenses or project costs.

Citation: Okla. Stat. Tit. 68, § 1001 (D) (3) (2003)
Effective dates: July 1, 2000, through June 30, 2006

Tax Exemption for Tertiary Recovery

The incremental production from approved tertiary recovery projects begun on or after July 1, 1988, and before July 1, 2006, is exempt from gross production tax for a period of ten (10) years or expire upon project payback, whichever occurs first. Project payback provides for recovery of capital and operating expenses. Administrative expenses and capital expenses of pipelines built to transport carbon dioxide to a project are excluded.

Citation: Okla. Stat. Tit. 68, § 1001 (D) (4) (2003)
Effective dates: July 1, 1988 through June 30, 2006
Goal: To encourage operators to increase ultimate recovery by employment of tertiary recovery techniques.

GROSS PRODUCTION INCENTIVE REBATES

In an effort to sustain the existing production of oil and gas in Oklahoma and encourage the drilling of new wells, legislation was enacted in 1994 that exempts the Gross Production Tax levied on oil and gas produced from certain wells. The exemption is equal to 6/7ths of the 7% Gross Production Tax and is rebated back to producers of qualified wells. Producers are eligible to file claims for refund on a July through June fiscal year basis.

Wells qualifying for the exemption are as follows:

- **Horizontally Drilled Wells:**

Wells qualifying for this rebate must be drilled in a manner which encounters and subsequently produces from a geological formation at an angle in excess of seventy (70) degrees from the vertical and which laterally penetrates a minimum of one hundred and fifty feet into the pay zone of the formation. For wells producing after July 1, 1994 and prior to July 1, 2002, the rebate shall be 24 months or ending upon payback. For wells producing after July 1, 2002 and prior to July 1, 2006, the rebate shall be 48 months or ending upon payback.

Citation: Okla. Stat. Tit. 68, § 1001 (E) (2003)
Goal: To encourage the use of new technology and increase recovery.

- **The reestablished production of a well that was non-productive:**

A well on which work to reestablish production commenced on or after July 1, 1994, and on or before June 30, 1997, that has not produced oil, gas, or oil and gas for a period of not less than two (2) years, as evidenced by the appropriate forms on file with the Oklahoma Corporation Commission reflecting the well's status.

A well on which work to reestablish production commenced on or after July 1, 1997, and on or before June 30, 2006, that has not produced oil, gas, or oil and gas for a period of not less than one (1) year, as evidenced by the appropriate forms on file with the Oklahoma Corporation Commission, reflecting the well's status.

A well which, after July 1, 1997, experiences mechanical failure or loss of mechanical integrity, as defined by the Corporation Commission, including, but not limited to, casing leaks, collapse of casing, or loss of equipment in a wellbore, or any similar event which causes cessation of production and results in a workover of the well, as evidenced by the use of a workover rig or other mechanical device being placed over the well to repair the well or equipment.

Qualified wells are exempt for a period of 28 months from the date production was reestablished.

Citation: Okla. Stat. Tit. 68 § 1001 (F) (2003)
Goal: To increase production from existing fields.

• **Production enhancements such as workovers and recompletions,**

"Recompletion" means:

(A) For production enhancement projects having a project beginning date prior to July 1, 1997, any downhole operation in an existing oil well or gas well that is conducted to establish production of oil or gas from any geological interval not currently completed or producing in such existing oil or gas well.

(B) For production enhancement projects having a project beginning date on or after July 1, 1997, and prior to July 1, 2003, any downhole operation in an existing oil well or gas well that is conducted to establish production of oil or gas from any geologic interval not currently completed or producing in such existing oil or gas well within the same or a different geologic formation.

"Workover" means any downhole operation in an existing oil or gas well that is designed to sustain, restore or increase the production rate or ultimate recovery in a geologic interval currently completed or producing in said existing oil or gas well. For production enhancement projects having a project beginning date prior to July 1, 1997, **"workover"** includes, but is not limited to, acidizing, reperforating, fracture treating, sand/paraffin removal, casing repair, squeeze cementing, or setting bridge plugs to isolate water productive zones from oil or gas productive zones, or any combination thereof. For production enhancement projects having a project beginning date on or after July 1, 1997, and prior to July 1, 2006, **"workover"** includes, but is not limited to, acidizing; reperforating; fracture treating; sand, paraffin, or scale removal or other wellbore cleanouts; casing repair; squeeze cementing; installation of compression on a well or group of wells or artificial lifts on oil, gas, or oil and gas, wells, including plunger lifts, rod pumps, submersible pumps and coiled tubing velocity strings; downsizing existing tubing to reduce well loading; downhole commingling; bacteria treatments; upgrading the size of pumping unit equipment; setting bridge plugs to isolate water production zones; or any combination thereof. **"Workover"** shall not mean the routine maintenance, routine repair, or like-for-like replacement of downhole equipment such as rods, pumps, tubing, packers, or other mechanical devices.

Qualified production enhancements shall be exempt for a period of 28 months from the date of first sale after project completion.

Citation: Okla. Stat. Tit. 68 § 1001 (G) (2003)
Goal: To encourage operators to increase production from existing fields by performing such work.

• **Deep Wells,**

For purposes of qualifying for the exemption, **"depth"** means the length of the maximum continuous string of drill pipe utilized between the drill bit face and the drilling rig's kelly bushing.

Deep wells spudded between July 1, 1994, and June 30, 1997, and drilled to a depth of 15,000 feet or greater shall be exempt from gross production tax beginning with the date of first sale for a period of twenty-eight (28) months.

Deep wells spudded between July 1, 1997, and June 30, 2002, and drilled to a depth of 12,500 feet or greater shall be exempt from gross production tax for a period of twenty-eight (28) months beginning with the date of first sale.
Deep wells spudded between July 1, 2002, and June 30, 2006, and drilled between a depth of 12,500 and 14,999 feet shall be exempt from gross production tax for a period of twenty-eight (28) months beginning with the date of first sale. Deep wells spudded between July 1, 2002, and June 30, 2006, and drilled between a depth of 15,000 and 17,499 feet shall be exempt from gross production tax for a period of forty-eight (48) months beginning with the date of first sale. Deep wells spudded between July 1, 2002, and June 30, 2006, and drilled between a depth of 17,500 feet or greater shall be exempt from gross production tax for a period of sixty (60) months beginning with the date of first sale.

Citation: Okla. Stat. Tit. 68, § 1001 (H) (2003)
Goal: To stimulate natural gas development in Oklahoma.

• **Wells classified as "New Discovery",**

"New discovery" means production of oil, gas, or oil and gas from:

(A) A well, spudded or reentered prior to July 1, 1997, which discovers crude oil in paying quantities, and is located more than one (1) mile from the nearest oil well producing from the same interval.

(B) A well, spudded or reentered on or after July 1, 1997, and prior to July 1, 2006, which discovers crude oil in paying quantities, and is located more than one (1) mile from the nearest oil well producing from the same interval of the same formation.

(C) A well, spudded or reentered prior to July 1, 1997, which discovers crude oil in paying quantities beneath current production in a deeper producing formation, located more than one (1) mile from the nearest oil well producing from the same deeper interval.

(D) A well, spudded or reentered on or after July 1, 1997, and prior to July 1, 2006, which discovers crude oil in paying quantities beneath current production in a deeper producing interval, located more than one (1) mile from the nearest oil well producing from the same deeper interval.

(E) A well, spudded or reentered prior to July 1, 1997, which discovers natural gas in paying quantities, and is located more than two (2) miles from the nearest gas well producing from the same producing interval.

(F) A well, spudded or reentered on or after July 1, 1997, and prior to July 1, 2006, which discovers natural gas in paying quantities, and is located more than two (2) miles from the nearest gas well producing from the same producing interval.

(G) A well, spudded or reentered prior to July 1, 1997, which discovers natural gas in paying quantities beneath current production in a deeper producing interval, that is more than two (2) miles from the nearest gas well producing from the same deeper interval.

(H) A well, spudded or reentered on or after July 1, 1997, and prior to July 1, 2006, which discovers natural gas in paying quantities beneath current production in a deeper producing interval, that is more than two (2) miles from the nearest gas well producing from the same deeper producing interval.

Qualified new discovery wells shall be exempt for a period of 28 months from the date of first sales.

Citation: Okla. Stat. Tit. § 1001 (I) (2003)

- **Wells meeting the criteria as being "Economically at Risk":**

Operators may apply to the Oklahoma Tax Commission for a rebate of 6/7^{ths} of the gross production tax upon demonstrating that they operate an oil lease that is economically at-risk. A lease must operate at a net loss or a net profit which is less than the severance tax paid for the lease during the previous tax year. Gross production tax exemptions under this section are limited to production from calendar years 1997 and 1998.

Citation: Okla. Stat. Tit. 68, § 1001.3 (2000)

- **Wells that are drilled and completed based on 3-D seismic technology.**

Operators producing oil, gas or oil and gas from a well, drilling of which is commenced after July 1, 2000, and prior to July 1, 2006, located within the boundaries of a three-dimensional seismic shoot and drilled based on three-dimensional seismic technology, may apply to the Tax Commission for a rebate of gross production tax paid in the previous fiscal year upon qualifying such well with the Oklahoma Corporation Commission.

Qualified projects shall be exempt for a period of 18 months from the date of first sale for seismic shot prior to July 1, 2000. Projects shot after July 1, 2000 and prior to July 1, 2006 shall be exempt for a period of 28 months from the date of first sale.

Citation: Okla. Stat. Tit. 68, § 1001 (J) (2003)

REBATE PRICE CAP

The exemption as it pertains to each project with the exception of horizontally drilled wells, is contingent upon the average calendar year price of oil and gas. In the event the average calendar year price of Oklahoma oil or gas as determined by the Tax Commission should exceed the established price cap provided for by statute, the exemption for the affected product would be cancelled for the applicable fiscal year period.

An example of the average price exceeding the cap occurred in calendar year 2001 wherein the established price cap for gas was three dollars and fifty cents ($3.50) per mmbtu. The average price of gas in 2001 was three dollars and seventy cents ($3.70) per mmbtu. The price cap for gas was exceeded and the exemptions from gross production tax on gas were cancelled for the production period of July 2001 through June 2002.

Since the inception of the exemptions, the price cap has been amended several times for both products. The price cap applicable to the most current calendar year (2002) is Thirty Dollars ($30.00) per barrel of oil and Five Dollars ($5.00) per one thousand cubic feet (mcf) of gas. Based on the average price of both oil and gas for calendar year 2002 as determined by the Tax Commission, neither product exceeded the established cap. Therefore, the exemptions for the production period of July 2002 though June 2003 shall be eligible for rebate beginning July 1, 2003.

If you should have any questions or need additional information, you may contact me at 522-5739.

This response applies only to the circumstances set out in your request of May 13, 2003. Pursuant to Commission Rule 710:1-3-73(e), this Letter Ruling may be generally relied upon only by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

Sincerely,

Mark J. Hendrix
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