Cost & Capital

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Bakken Oil Tax Incentives

Key Takeaways

- **Production Tax Holiday –** Oil producers in North Dakota, including the Bakken shale play should benefit from a production tax holiday triggered by low crude oil prices.
- **Production Triggers –** North Dakota has two sets of triggers for current and existing wells linked to the WTI (West Texas Intermediate) benchmark price minus $2.50. For 2015, that trigger has been set at $52.59.
- **New Wells –** The trigger has already been in effect for one month, so all new wells will be taxed at 2% of production value compared to the standard 6.5%. This incentive lasts for the first 18 months, or 75,000 barrels, or $4.5 million of gross value or until the WTI benchmark exceeds $72.50 for a single month.
- **Existing Wells –** If the WTI benchmark minus $2.50 per barrel is below the trigger for five consecutive months, new and existing wells will receive a tax holiday for the 6.5% production tax for the following 18 months.
- **Impact for Producers –** If the five month trigger is hit, producers will receive a tax benefit ranging from $2.60 to $3.00 per barrel. At current WTI prices, many Bakken producers are just covering cash costs and may not be able to reinvest in drilling operations without higher crude prices.

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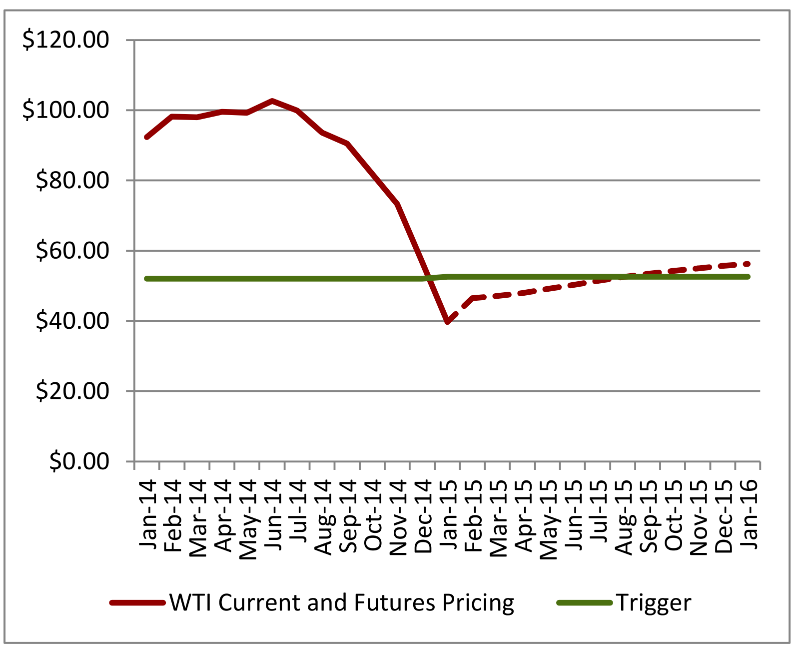
Trigger Calculation

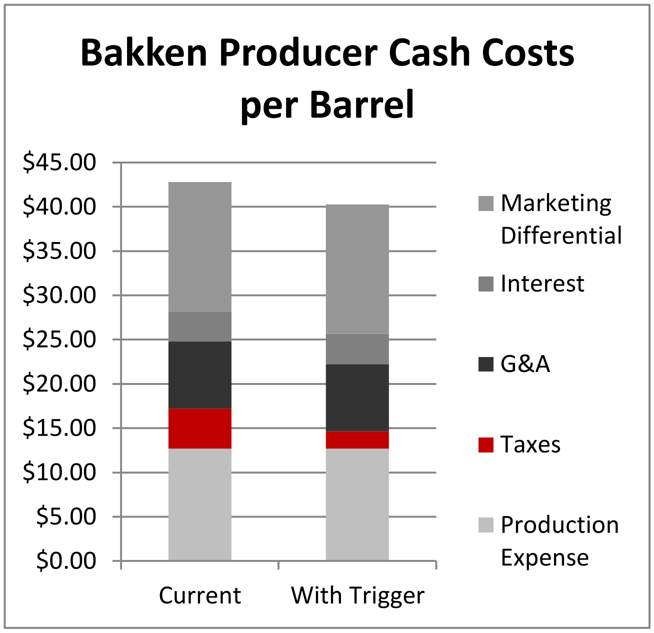


North Dakota calculates oil taxes using a formula based on the benchmark WTI market price to determine the trigger for the oil extraction tax. In 2014, the trigger was set at $52.06 and increased to $52.59 for 2015. If the price for WTI minus $2.50 is below the trigger for one month, then all new wells completed in that month qualify for a reduced tax of 2%. If WTI minus $2.50 is below the trigger for 5 consecutive months, then all wells have the 6.5% extraction tax reduced to 0% for 18 months.

Based on the current and futures market pricing for WTI, the tax trigger should be enacted May 2015.

Cash Impact

The current tax on oil production for the State of North Dakota includes a gross production tax of 5.0% of the gross value and an oil extraction tax of 6.5%. When Bakken producers were able to generate $90 / bbl. last year, the taxes ranged from $8-$10 per bbl. With lower crude oil prices, taxes per barrel produced in North Dakota are currently less than $4.00 per bbl. The 6.5% tax holiday will reduce the effective taxes producers pay per barrel by $2.50 to $3.00.



The impact for shale producers is significant due to the higher operating costs for horizontal wells with hydraulic fracturing. The cash costs, which are costs associated with the operation of the wells and marketing of the oil, but not including the initial investment and depletion is near the breakeven point. At the current level of crude pricing, shale producers are just covering daily cash costs to produce and market the barrels of oil. The tax holiday will support producers and improve cash flow during lower oil pricing periods.

The incentive is not enough to encourage new oil production. With average investment costs ranging from $20-$25 per barrel, WTI would need to rise above $70 per barrel before drilling and completing new wells becomes economical. As seen in the chart below, the tax holiday will reduce some of the cash costs for producing a barrel, but compared to the costs of drilling and operating a well in the Bakken region, investment should be modest for foreseeable future until prices rise significantly.