

Manitoba Petroleum Fiscal Regime

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Provincial Crown Oil & Gas Royalties

Provincial Freehold Oil & Gas Production Taxes

Drilling Incentive Program

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MANITOBA PETROLEUM FISCAL REGIME

INTRODUCTION

This publication provides a summary of Manitoba's petroleum fiscal regime including Provincial Crown Oil Royalties and Freehold Production Oil Tax. It also outlines the Manitoba Drilling Incentive Program designed to encourage investment in the sustainable development of the Province's petroleum resources.

The Province's petroleum fiscal regime is established under *The Oil and Gas Act and The Oil and Gas Production Tax Act* and related regulations.

Access to these statutes published by Manitoba's Statutory Publications is available on the Petroleum Branch website at the following address:

<http://www.manitoba.ca/iem/petroleum/actsregs/home.html>

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OIL CLASSIFICATION

Oil produced in Manitoba is classified in one of four categories, **old oil**, **new oil**, **third tier oil** and **holiday oil**.

Old Oil includes

- oil produced from a well drilled prior to April 1, 1974 that does not qualify as new oil or third tier oil.

New Oil includes

- oil that is not third tier oil and is produced from a well drilled on or after April 1, 1974 and prior to April 1, 1999;
- oil produced from an abandoned well re-entered on or after April 1, 1974 and prior to April 1, 1999;

- oil produced from an old oil well that, in the opinion of the Director, can be reasonably attributed to an increase in reserves from an enhanced recovery project implemented after April 1, 1974 and prior to April 1, 1999; or
- oil produced from a horizontal well.

Third Tier Oil includes

- oil produced from a vertical well drilled on or after April 1, 1999;
- oil produced from an abandoned well that is re-entered on or after April 1, 1999;
- oil produced from an inactive vertical well, activated after April 1, 1999;
- oil produced from a marginal well that has undergone a major workover; or
- oil produced from an old oil well or new oil well that, in the opinion of the Director, can be reasonably attributed to an increase in reserves from an enhanced recovery project implemented under *The Oil and Gas Act* after April 1, 1999.

Holiday Oil includes

- oil production that is exempt from any royalty payable under the *Crown Royalty and Incentives Regulation*, or any tax payable under the *Oil and Gas Production Tax Regulation*. Note that wells drilled or receiving a marginal well major workover incentive after December 31, 2013 and prior to January 1, 2019, have a requirement to pay a minimum royalty on Crown production and a minimum tax on freehold production.

PROVINCIAL CROWN OIL ROYALTIES

The royalty on production from Provincial Crown oil and gas rights is determined under the *Crown Royalty and Incentives Regulation of The Oil and Gas Act*.

Crown royalty is a function of the monthly oil production from a spacing unit, or oil production allocated to a unit tract under a unit agreement or order.

The formulae used for the determination of Crown Royalty are shown in Table 1.

Figure 1 and Table 2 show Crown oil royalty rates as a function of production.

Crown oil royalty rates are not price sensitive.

For horizontal wells, Crown royalty is calculated per spacing unit based on oil production allocated to the spacing units within the drainage unit of the well, as determined under the *Crown Royalty and Incentives Regulation* (Figure 2).

Table 1: Manitoba Crown Oil Royalty Determination

MONTHLY PRODUCTION (m ³) (calculated to nearest 0.1 m ³)	CROWN ROYALTY VOLUME (m ³) (calculated to nearest 0.01 m ³)
0 to 50	$K \times P^2/265$
over 50	$K \times (9.43 + 0.45 (P-50))$

K is equal to one of the following multiplying factors:

- 0.00 Holiday Oil
- 0.47 Third Tier Oil
- 0.55 New Oil
- 1.00 Old Oil

P is the monthly oil production in cubic metres (m³)

$$\text{CROWN ROYALTY RATE (\%)} = \frac{\text{CROWN ROYALTY VOLUME}}{\text{MONTHLY PRODUCTION}} \times 100$$

Figure 1: Manitoba Crown Oil Royalty Rates (%)

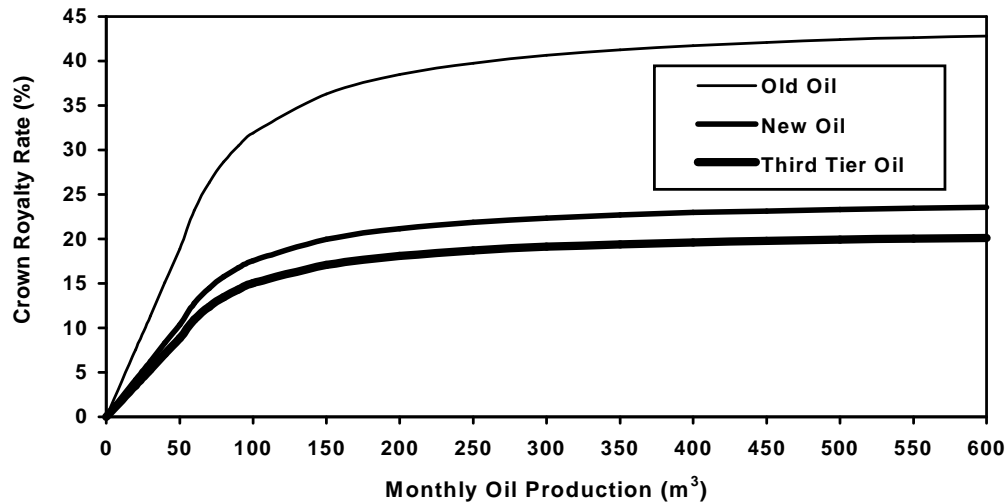


Table 2: Manitoba Crown Oil Royalty Rates (%) – Example

PRODUCTION (m ³ /month)	HOLIDAY OIL	THIRD TIER OIL	NEW OIL	OLD OIL
0	0.0	0.0	0.0	0.0
20	0.0	3.5	4.2	7.5
30	0.0	5.3	6.2	11.3
40	0.0	7.1	8.3	15.1
50	0.0	8.9	10.4	18.9
60	0.0	10.9	12.8	23.2
70	0.0	12.4	14.5	26.3
80	0.0	13.5	15.8	28.7
90	0.0	14.3	16.8	30.5
100	0.0	15.0	17.6	31.9
150	0.0	17.1	20.0	36.3
200	0.0	18.1	21.2	38.5
250	0.0	18.7	21.9	39.8
300	0.0	19.1	22.4	40.6
350	0.0	19.4	22.7	41.3
400	0.0	19.6	23.0	41.7
450	0.0	19.8	23.2	42.1
500	0.0	19.9	23.3	42.4
550	0.0	20.0	23.4	42.6
600	0.0	20.0	23.6	42.8

Minimum Crown Royalty

For a well drilled after December 31, 2013 and before January 1, 2019, there is a requirement to pay a minimum Crown royalty. The royalty payment will be required on the following volumes:

1. (a) 8,000 m³ if the well is
 - (i) a horizontal well,
 - (ii) a deep development well completed for production in the Birdbear Formation or a deeper formation, or
 - (iii) a deep exploratory well drilled below the Birdbear Formation; or
- (b) 4,000 m³ if the well is a non-deep exploratory well drilled more than 1.6 kilometres from a well cased for production from the same or deeper zone; or
- (c) 500 m³ if the well is a vertical oil well that is not subject to subclauses (a) or (b);

2. 500 m³ if the well was a marginal oil well that undergoes a major workover after December 31, 2013 but before January 1, 2019.

The royalty payable is the lesser of

- (a) 3% of the volume of the oil produced for each producing month; or
(b) the royalty that would be payable for each producing month if the well production was not classified as holiday oil.

Minimum Crown Royalty Rate Example

A vertical well finished drilling on January 31, 2014 and because it was drilled on or after April 1, 1999, oil produced from the well is classified as third tier oil. The well received 500 m³ of holiday oil volume and started producing on February 2, 2014. Oil produced from the first month was 300 m³.

Step 1: The Crown royalty volume for February is calculated using a 3% royalty rate:

$$300 * .03 = 9.00 \text{ m}^3$$

Step 2: The Crown royalty volume is calculated as if the well was not on holiday:

$$\begin{aligned} &K \times (9.43 + .45(P-50)) \\ &\text{The third tier K factor is } .47 \\ &.47 \times (9.43 + .45(300-50)) \\ &\text{Crown royalty volume is } 57.31 \text{ m}^3 \end{aligned}$$

Step 3: The Crown royalty payable would be 9.00 m³ because it is the lesser volume.

This well produces for two months and in April 2014 produced 50 m³. The well had a remaining holiday volume of 20 m³.

Step 1: The Crown royalty volume for April on the holiday production will be calculated using a royalty rate of 3%.

$$50 \times .03 \times (20/50) = 0.60 \text{ m}^3$$

Step 2: The Crown royalty volume is calculated as if the well was not on holiday

$$\begin{aligned} &K \times P^2/265 \\ &\text{The third tier K factor is } .47 \\ &.47 * 50^2/265 \\ &\text{Calculated Crown royalty volume is } 4.43 \text{ m}^3 \\ &\text{Crown royalty volume on the holiday production is } 4.43 \times (20/50) = \\ &1.77 \text{ m}^3 \end{aligned}$$

Step 3: The Crown royalty payable on the holiday production (20 m³) would be 0.60 m³ because it is the lesser volume.

Step 4: The Crown royalty volume on the non-holiday production is:

$$K \times P^2/265$$

The third tier K factor is .47

$$.47 \times 50^2/265$$

Calculated Crown royalty volume is 4.43 m³

Crown royalty volume on the non-holiday production is 4.43 x (30/50) = 2.66 m³

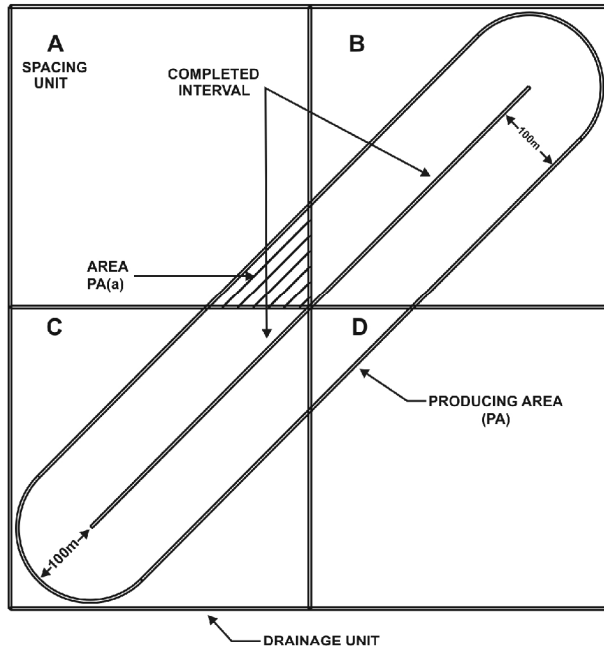
Step 5: Combine the holiday and non-holiday production Crown royalty volumes to obtain the total Crown royalty volume:

$$0.60 + 2.66 = 3.26 \text{ m}^3$$

Figure 2: Determination of Production Allocation for Horizontal Wells

Determination of Production Allocation

Example: Single Leg Horizontal Well



$$A = HWP \times \frac{PA(a)}{PA}$$

Where:

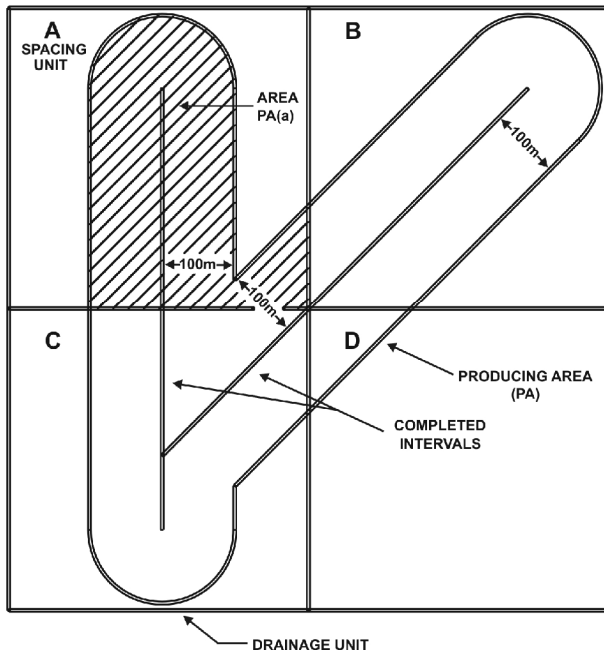
A is the production allocated to spacing unit A;

HWP is the production from the horizontal well in cubic metres (m³)/month;

PA (a) is the area of the producing area within spacing unit A, and;

PA is the producing area of the horizontal well determined in accordance with the Crown Royalty and Incentives Regulation.

Example: Multi Leg Horizontal Well



PROVINCIAL FREEHOLD OIL PRODUCTION TAXES

The Oil and Gas Production Tax Act levies a tax on production from freehold oil and gas rights. The tax is based on monthly production from a spacing unit, or production allocated to a unit tract under a unit agreement or order.

For horizontal wells, the tax is calculated per spacing unit based on the production allocated to spacing units within the drainage area in accordance with any production allocation agreement. If there is no production allocation agreement, it is assumed that the horizontal well's production is divided equally among all spacing units in the drainage unit.

The Act provides that the operator of a well is responsible for payment of the tax on any freehold oil production. The oil and gas rights owner's and any other royalty or working interest owner's share of the tax is deducted from the payment made to them by the operator from the sales revenue.

A working interest owner, who takes its oil in kind and markets the oil, may be designated by the Director as a special operator. A special operator is responsible for filing returns and payment of the tax for its share of the production.

The freehold oil production tax is determined under *The Oil and Gas Production Tax Regulation* and is based on the formulae shown in Table 3.

Figure 3 and Table 4 show freehold oil production tax rates as a function of production.

Freehold oil production tax rates are not price sensitive.

Table 3: Manitoba Freehold Oil Production Tax Rate (%) Determination

OIL CLASSIFICATION	MONTHLY PRODUCTION (m ³) (calculated to nearest 0.1 m ³)	TAX RATE (%) (calculated to nearest 0.01 %)
HOLIDAY OIL	All Volumes	0.00
THIRD TIER OIL	46.0 or less	0.00
	over 46.0	11 – 465/P
NEW OIL	36.0 or less	0.00
	over 36.0, and less than 65.0	0.23P – 8.11
	65.0 and over	19.59 – 820/P
OLD OIL	20.0 or less	0.00
	over 20.0, and less than 65.0	0.43P – 8.24
	65.0 and over	42.76 – 1500/P

P is the monthly oil production in cubic metres (m³)

Figure 3: Manitoba Freehold Oil Production Tax Rates (%)

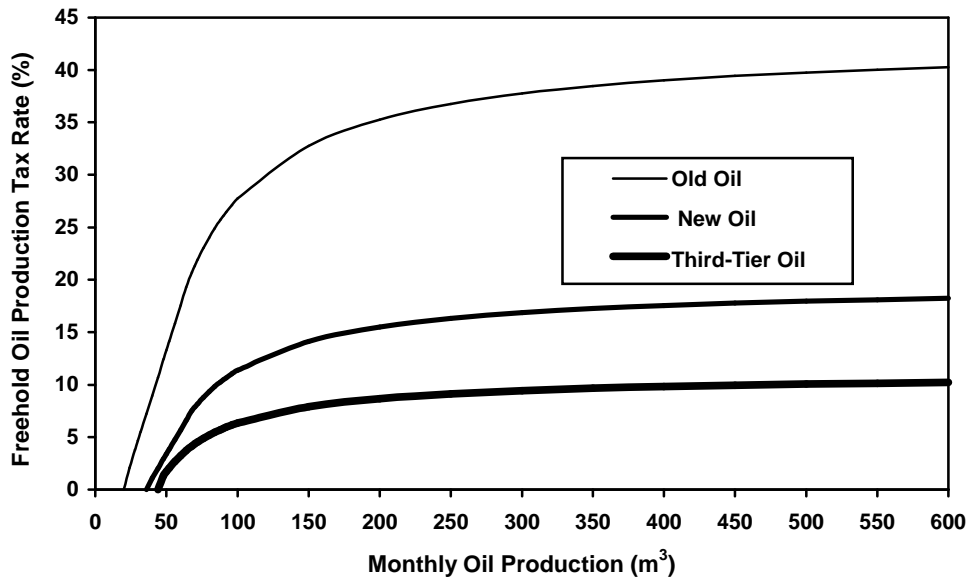


Table 4: Freehold Oil Production Tax Rates (%) - Example

PRODUCTION (m ³ /month)	HOLIDAY OIL	THIRD TIER OIL	NEW OIL	OLD OIL
0	0.0	0.0	0.0	0.0
20	0.0	0.0	0.0	0.0
30	0.0	0.0	0.0	4.7
40	0.0	0.0	1.1	9.0
50	0.0	1.7	3.4	13.3
60	0.0	3.3	5.7	17.6
70	0.0	4.4	7.9	21.3
80	0.0	5.2	9.3	24.0
90	0.0	5.8	10.5	26.1
100	0.0	6.4	11.4	27.8
150	0.0	7.9	14.1	32.8
200	0.0	8.7	15.5	35.3
250	0.0	9.1	16.3	36.8
300	0.0	9.5	16.9	37.8
350	0.0	9.7	17.2	38.5
400	0.0	9.8	17.5	39.0
450	0.0	10.0	17.8	39.4
500	0.0	10.1	18.0	39.8
550	0.0	10.2	18.1	40.0
600	0.0	10.2	18.2	40.3

Minimum Production Tax

For a well drilled after December 31, 2013 and before January 1, 2019, there is a requirement to pay a minimum production tax. As with Crown royalties the payment will be based on the volumes established in the Crown Royalty and Incentives Regulation for minimum Crown royalty volumes. The production tax payment will be required on the following volumes:

1. (a) 8,000 m³ if the well is
 - (i) a horizontal well,
 - (ii) a deep development well completed for production in the Birdbear Formation or a deeper formation, or
 - (iii) a deep exploratory well drilled below the Birdbear Formation, or

(b) 4,000 m³ if the well is a non-deep exploratory well drilled more than 1.6 kilometres from a well cased for production from the same or deeper zone: or

(c) 500 m³ if the well is a vertical oil well that is not subject to subclauses (a) or (b);

2. 500 m³ if the well was a marginal oil well that undergoes a major workover after December 31, 2013 but before January 1, 2019.

The production tax payable on holiday volumes is the lesser of

(a) 1% tax rate for oil produced for each producing month; or

(b) the production tax that would be payable for each producing month if the well production was not classified as holiday oil.

Minimum Production Tax Rate Example

A horizontal well finished drilling on January 31, 2014. Oil produced from a horizontal well is classified as new oil. The well received 8,000 m³ of holiday oil volume and started producing on February 2, 2014. Oil produced from the first month was 300 m³ and was allocated equally to two spacing units.

Step 1: The production tax for February is calculated as if the well was not on holiday. Because the horizontal allocation is 50/50 and the production was 300 m³, the production for each spacing unit would be 150 m³.

Step 2: The tax rate for each spacing unit would be calculated using the formula:

$$19.59 - 820/p = 19.59 - 820/150 = 14.12\% \text{ tax rate}$$

Step 3: Because the well is on holiday, the production tax rate would be 1% because it is the lesser rate. Production tax for the second spacing unit would also be calculated using a 1% production tax rate.

Twenty-six months later in April 2016 the well has 10 m³ of holiday oil remaining and has produced 90 m³ during a month.

Step 1: The production tax for April is calculated as if the well was not on holiday. Because of the 50/50 allocation, each spacing unit would be allocated 45 m³ of oil production and the remaining holiday volume of 10 m³ would be split between the two spacing units.

Step 2: The tax rate would be calculated based on 45 m³:

$$.23P - 8.11 = .23(45) - 8.11 = 2.24\% \text{ tax rate}$$

Step 3: The holiday oil volume of 5 m³ is subjected to a tax rate of 1% (the lesser of the 2.24% or 1% minimum production tax rate).

Step 4: The remaining 40 m³ oil that is not holiday oil is subject to a tax rate of 2.24%.

Step 5: Total tax payable for each spacing unit is $0.90 + .05 = 0.95$ m³.

PROVINCIAL GAS ROYALTIES AND TAXES

The provincial Crown royalty payable on gas is equal to 12.5% of the volume sold, calculated for each production month.

The Provincial freehold tax on gas is equal to 1.2% of the volume sold, calculated for each production month.

There is no Crown royalty or freehold tax payable on gas consumed as lease fuel.

MANITOBA DRILLING INCENTIVE PROGRAM

The Manitoba Drilling Incentive Program provides the licensee of newly drilled wells, or qualifying wells where a major workover has been completed, with a "holiday oil volume".

"Holiday oil volumes" must be produced within 10 years of the finished drilling date of a newly drilled well, or the completion date of a major workover on a marginal well.

A new well drilled or receiving a marginal/major workover incentive after December 31, 2013 and before January 1, 2019 will be required to pay a minimum Crown royalty, or if the well is producing from freehold oil and gas rights, a minimum production tax during the production of holiday oil. Examples for the calculation of taxes and royalties for holiday oil are detailed in previous sections.

Wells drilled or converted for purposes of injection in an approved enhanced recovery project earn a one year exemption from the payment of Crown royalty or freehold production tax on production allocated to the unit tract in which an injection well is located.

The program consists of 7 components:

1. Vertical Well Incentive
2. Exploration and Deep Well Incentive
3. Horizontal Well Incentive
4. Marginal Well Major Workover Incentive
5. Pressure Maintenance Project Incentive
6. Solution Gas Conservation Incentive
7. Holiday Oil Volume Account

1. Vertical Well Incentive

The program provides the licensee of a vertical development or exploratory well drilled after December 31, 2013 and prior to January 1, 2019 with 500 m³ of holiday oil volume. To qualify the well must be drilled less than 1.6 kilometres from the nearest well cased for production from the same or a deeper zone.

2. Exploration and Deep Well Incentive

Under the Exploration and Deep Well Incentive an exploratory well or deep development well drilled after December 31, 2013 or prior to January 1, 2019 earns a HOV as follows:

- (a) Non-deep exploratory well drilled more than 1.6 kilometres from a well cased for production from the same or a deeper zone earns a HOV of 4,000 m³;
- (b) Deep exploratory well drilled below the Birdbear Formation earns a HOV of 8,000 m³; and
- (c) Deep development well completed for production in the Birdbear or deeper formation earns a HOV of 8,000 m³.

3. Horizontal Well Incentive

Any horizontal well (defined as a well that achieves an angle of at least 80 degrees from the vertical for a minimum distance of 100 m) that is drilled after December 31, 2013 or prior to January 1, 2019, earns a holiday oil volume of 8,000 m³.

4. Marginal Well Major Workover Incentive

Any marginal well where a major workover is completed prior to January 1, 2019 earns a holiday oil volume of 500 m³.

A **marginal oil well** is defined as an abandoned well, or well that,

- was not operated over the previous 12 months, or
- produced oil at an average rate of less than 3 m³ per operating day, as determined by the Director of Petroleum.

A **major workover** includes:

- the re-entry of an abandoned well;
- the deepening of a well into a new formation;
- the recompletion of a well from one pool to another;
- the drilling of a horizontal leg
- the repair of the casing in a well by installation of a new string of casing or by other means as approved by the Director in advance; and,
- any other workover that, in the opinion of the Director will cost more than \$75,000 and is designed to increase recovery from a pool.

Upon completion of a major workover on a marginal well, any production from a vertical well is classified as **third tier oil**. Horizontal well production retains the new oil classification.

5. Pressure Maintenance Project Incentive

The Pressure Maintenance Project Incentive (PMPI) provides for a one year exemption from the payment of Crown royalty or freehold production tax on production allocated to a unit tract in which an injection well is drilled or a well is converted to water injection.

Wells eligible for the PMPI include those drilled for the purpose of injection in an approved enhanced recovery project, as well as vertical or horizontal wells that are converted to injection.

The PMPI exemption is for one year beginning in the month in which injection commenced and applies for a vertical well, to the unit tract in which the well is located; and for a horizontal well, to the four unit tracts containing the majority of the injection area, as determined by the Director of Petroleum (defined as the area within 100 m of the completed interval of the horizontal well; Figure 2).

Under the PMPI, for a well that is converted to injection after December 31, 2013 and before January 1, 2019, the exemption period will be extended to 18 months beginning in the month in which injection commenced, if the well has remaining holiday oil volume.

6. Solution Gas Conservation Incentive

The province has introduced a new Solution Gas Conservation Incentive, the purpose of which is to encourage the implementation of new projects that capture solution gas. To obtain the

incentive, the proponent must make application to the Director of Petroleum. Approved projects implemented after December 31, 2013 will be exempt from the payment of Crown royalty and production tax on gas produced from the project until December 31, 2018.

7. Minimum Crown Royalty and Production Tax

A well drilled or receiving a marginal/major workover incentive after December 31, 2013 and before January 1, 2019 will be required to pay a minimum Crown royalty, or if the well is producing from freehold oil and gas rights, a minimum production tax. Examples for the calculation of taxes and royalties for holiday oil are detailed in previous sections.

8. Holiday Oil Volume Account

Previous iterations of the Manitoba Drilling and Incentive Program provided a Holiday Oil Volume Account which was established for each company earning holiday oil. The Account allowed for the movement of holiday oil volume to and from wells under specific conditions.

As of January 1, 2015, Holiday Oil Volume Accounts will be eliminated. Until December 31, 2014, a holder of an Account will be able to make a one-time transfer of 2,000 m³ of holiday oil to a well drilled during the period January 1, 2014 to December 31, 2014. To implement the transfer, the holder of the holiday account must contact the Petroleum Registrar for approval.

For the period January 1, 2014 to January 1, 2015, holiday oil volume may not be transferred from individual wells to the account.

QUESTIONS AND ANSWERS

Q1 What is a "Holiday Oil Volume Account" and when will they be extinguished?

A1 A **Holiday Oil Volume Account** is administered by the Branch. The account is established for each company (licensee) for all wells that qualify under previous iterations of Manitoba Drilling Incentive Program. The account reflected all well activity and holiday oil volume assignments under the program. **As of January 1, 2015 all holiday oil volume accounts will be extinguished. As of January 1, 2014, no holiday oil may be transferred from a well to a holiday oil volume account.**

Q2 Can earned holiday volumes be transferred from one company account to another?

A2 No. As of January 1, 2014, no transfers of existing holiday accounts is allowed.

Q3 Can holiday oil be transferred from the holiday oil volume account to a new well?

A3 Yes. For well drilled after December 31, 2013 and prior to January 1, 2015, a one-time assignment of 2,000 m³ made be made from the holiday oil volume account to the well. The transfer request must be made to the registrar prior to January 1, 2015.

Q4 Can a horizontal well earn more than 8,000 m³ if an additional leg is drilled?

A4 Yes. Under the provision of the marginal/major workover incentive, additional legs may receive 500 m³ of holiday oil. Application must be made to the Director of Petroleum.