



October 7, 2002

TO: ALL OPERATORS AND INTERESTED PARTIES

Dear Client:

Re: Changes to Saskatchewan's Oil and Gas Royalty/Tax Regime
and Corporation Capital Tax Surcharge for New Activity

The Honourable Lorne Calvert, Premier of Saskatchewan, today announced a number of major changes affecting the Crown royalty and freehold production tax structures and the Corporation Capital Tax Surcharge rate applicable to production from new oil and gas exploration and development activity. The News Release and Fact Sheet associated with the announcement can be found on the department's Web site at www.gov.sk.ca/enermine/about/semnew.htm. The changes are designed to provide a more competitive investment environment and a more simplified royalty/tax regime.

The following Crown royalty, freehold production tax and Corporation Capital Tax Surcharge changes are effective October 1, 2002:

1. The introduction of lower "fourth tier" production and price sensitive Crown royalty structures applicable to:
 - (a) conventional oil produced from oil wells (vertical and horizontal) and gas wells with a finished drilling date on or after October 1, 2002;
 - (b) incremental oil produced from new or expanded waterflood projects with a commencement date on or after October 1, 2002; and
 - (c) natural gas produced from gas wells with a finished drilling date on or after October 1, 2002.

The price sensitive parameters governing the new "fourth tier" royalty structures are as follows:

- (a) a base rate of 5% and marginal rate of 30% for both oil and gas;
- (b) a base price of \$100 per cubic metre for oil and \$50 per thousand cubic metres for gas; and
- (c) a reference well production rate of 250 cubic metres of oil per month and 250 thousand cubic metres of gas per month.

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For additional details on the "fourth tier" royalty formulas, refer to the Information Circulars PR-IC01 titled "Crude Oil Price Sensitive Royalty/Tax Structures" and PR-IC02 titled "Natural Gas Price Sensitive Royalty/Tax Structures", which have recently been updated. These Circulars are located on the department's Web site at www.gov.sk.ca/enermine/energy/engcirc.htm.

2. The introduction of lower "fourth tier" production and price sensitive freehold production tax structures applicable to conventional oil, incremental oil from new or expanded waterfloods and natural gas. The freehold production tax rates are determined by subtracting a production tax factor (PTF) of 12.5 percentage points from the corresponding Crown royalty rates.

Details of the "fourth tier" production tax formulas are also available in the Information Circulars noted above.

3. A reduction in the Corporation Capital Tax Surcharge rate from 3.6% to 2.0% for:
 - (a) all oil and gas that is produced from oil wells or gas wells with a finished drilling date on or after October 1, 2002; and
 - (b) incremental oil related to new or expanded enhanced oil recovery (EOR) projects or waterflood projects having a commencement date on or after October 1, 2002.

4. In conjunction with the lower "fourth tier" royalty/tax structures, a modified system of incentive volumes and maximum royalty/tax rates applicable to the initial production from oil wells and gas wells with a finished drilling date on or after October 1, 2002. The incentive volumes applicable to the various well types are as follows:

- (a) zero cubic metres for non-deep vertical development oil wells and development gas wells;
- (b) 4,000 cubic metres for non-deep vertical exploratory oil wells;
- (c) 6,000 cubic metres for non-deep horizontal oil wells;
- (d) 8,000 cubic metres for deep vertical development oil wells;
- (e) 16,000 cubic metres for deep vertical exploratory oil wells and deep horizontal oil wells; and
- (f) 25,000,000 cubic metres for exploratory gas wells (no change).

The oil and gas incentive volumes are subject to a maximum royalty rate of 2.5% and a freehold production tax rate of zero per cent.

5. The elimination of the re-entry and short section horizontal oil well royalty/tax categories. All horizontal oil wells with a finished drilling date on or after October 1, 2002 will receive the "fourth tier" royalty/tax rates and new incentive volumes.
6. An expansion of the "deep oil well" definition to mean:
 - (a) oil wells producing from a zone deeper than 1,700 metres, providing that the zone is within a geological system deposited during the Mississippian Period or earlier; or
 - (b) oil wells producing from a zone that was deposited before the Bakken zone regardless of the depth.
7. The introduction of a new Crown royalty and freehold production tax regime applicable to associated natural gas (gas produced from oil wells) that is gathered for use or sale and is produced from:
 - (a) oil wells with a finished drilling date on or after October 1, 2002; and
 - (b) oil wells with a finished drilling date prior to October 1, 2002, where the individual oil well has a gas-oil production ratio in any month of more than 3,500 cubic metres of gas for every cubic metre of oil.

Effectively, a royalty/tax will be payable on associated natural gas produced from an oil well that exceeds approximately 65 thousand cubic metres in a month. The royalty/tax rates are based on the new "fourth tier" natural gas royalty/tax structures (curved portion only).

With the introduction of the associated natural gas royalty/tax regime, oil and gas concurrent production applications approved after October 1, 2002 will not have the same royalty/tax implications as before. Gas produced from oil wells affected by concurrent production approvals after October 1, 2002 will only be subject to the associated natural gas royalty/tax regime and only if the oil wells meet the requirements of point (a) or (b) noted above.

For additional details on the associated natural gas royalty/tax regime and its administration, refer to the Information Circular PR-IC02 titled "Natural Gas Price Sensitive Royalty/Tax Structures" which has been recently updated. This Circular is located on the department's Web site at www.gov.sk.ca/enermine/energy/engcirc.htm.

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All the pertinent royalty/tax Information Circulars have been updated on the department's Web site at www.gov.sk.ca/enermine/energy/engcirc.htm.

In the upcoming months, the necessary royalty/tax regulation amendments will be prepared and put in force retroactive to October 1, 2002.

If you have any questions related to the Crown royalty and freehold production tax changes outlined above, please contact Dale Fletcher, Director of the Petroleum Royalties Branch at (306) 787-2605. For questions pertaining to the Corporation Capital Tax Surcharge, please contact Kelly Laurans, Director of Corporate Taxes and Incentives Branch with the Department of Finance at (306) 787-6690.

Sincerely,

Larry Spannier
Deputy Minister

cc: Dale Fletcher, Petroleum Royalties, Industry and Resources
Kelly Laurans, Corporate Taxes and Incentives, Finance

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