Ministry of Finance
Bulletin

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Net Profit Royalty Program

Petroleum and Natural Gas Act

Latest Revision: *The revision bar (|) identifies changes to the previous version of this bulletin dated February 2010. For a summary of the changes, see Latest Revision at the end of this document.*

This bulletin explains the royalty program for approved net profit projects. For general royalty information, see the ***Oil and Gas Royalty Handbook***.

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Overview

The net profit royalty program (NPRP) enables producers to pay lower royalty rates in the initial stages of a project in exchange for higher royalty rates once the producers have recovered their capital costs.

The original project approval defines the project ring fence as an area of land, and oil or gas pools underlying that area of land. Production of oil and natural gas from any well events within the project ring fence is subject to royalties under the NPRP. The project approval may also specify other conditions.

An NPRP project may include well events that were producing before the project was approved. However, NPRP royalties do not apply to production that occurred from such well events before project approval.

After approval, we calculate and assess NPRP royalties on production of oil and gas from NPRP well events.

Please note: Although this bulletin uses the term "royalties," the NPRP applies to tax on production from freehold land in the same manner.

Reporting Requirements for Operators

Historical Cost Reporting BC-50

After a project is approved, you report and allocate allowed historical costs to each of the producers for an approved NPRP project on the *Net Profit Historical Allowable Costs* (BC-50). Historical costs are allowed capital and operating costs incurred in the 60 months prior to, and including, the month the producer submits an application for approval under the NPRP. For a list of allowed costs, see the ***Net Profit Royalty Project Allowed Cost Order of the Administrator***.

You must deduct credits from the project's historical costs if:

- an NPRP project includes well events in wells that were spud before the project was approved, and summer drilling credits received prior to May 2008, or
- an NPRP project includes well events in wells that produced marketable gas before the project was approved, and deep well credits were applied to those wells.

The BC-50 is due on the last day of the second month following the month the project was approved. For example, if a producer applies for the NPRP in June and receives approval in October, the BC-50 is due December 31.

Monthly Costs Reporting BC-51

You report monthly costs for an approved NPRP project on the *Net Profit Monthly Allowable Capital and Operating Costs* (**BC-51**). You report the allowed capital and operating costs, and allocate the costs to each of the producers of the project.

Eligibility criteria for allowable costs are set out in the ***Net Profit Royalty Project Allowed Cost Order***. Allowable costs must be directly attributable to the project, incurred by the producer, reasonable in the circumstances, not recovered from another party and not specifically excluded. For a list of excluded costs, see the ***Net Profit Royalty Project Allowed Cost Order***.

Allowable capital and operating costs must be incurred in the project application month or later. You file your first BC-51 for the month following the project application month.

For months prior to the project approval month, the BC-51 is due on the last day of the second month after the project approval month. For example, if a producer applies for the NPRP in June and receives approval in October, the reports for July to October are due December 31.

For months after project approval, the BC-51 is due on the last day of the second month following the month in which the costs were incurred. A penalty is applied at a rate of $100 for each month, or partial month, the report is late.

Cost Reductions
If gas from non-NPRP well events is produced through facilities in an NPRP project and the gas is not owned by a producer with an interest in the NPRP project, you must subtract fees paid from the owner of that gas from the allowable NPRP project operating costs.

If gas from non-NPRP well events is produced through facilities in an NPRP project and the gas is owned by a producer with an interest in the NPRP project, you must subtract a monthly transportation allowance from the allowable NPRP project operating costs.

You calculate the monthly transportation allowance by multiplying the producer's volume of gas delivered from non-NPRP well events to NPRP facilities in the month by the transportation allowance rate. You calculate the transportation allowance rate annually by dividing the sum of eligible project operating costs and capital cost depreciation for the year by the volume of gas produced through the project facilities in the year.

Annual depreciation is equal to 5% of the depreciated eligible capital costs at the beginning of the year plus the eligible capital cost additions during the year. If the project operates for fewer than 12 months in the year, annual depreciation is reduced to the proportion of operating months in the year.

Please note: We may audit the costs you claim on the BC-51.

Revenue Reporting

We gather the revenue information necessary to assess the NPRP royalties from the following reports that producers must continue to complete.

Gas Revenue – The *Marketable Gas and By-Product Producer Allocations Report* (**BC-08**) provides us with the producer's share of marketable gas volumes from an NPRP well event. To determine the gas revenue for each NPRP well event, we multiply the marketable gas volume by the producer's gas price for the project.

We then add the gas revenues for each well event together to determine the producer's total gas revenue for an NPRP project. The Ministry of Energy, Mines and Petroleum Resources calculates the producer's gas price for the project in accordance with the ***Natural Gas Pricing Order***.

By-Product Revenue – The BC-08 provides us with the producer's by-product revenue from each NPRP well event. We add the by-product revenue from all NPRP well events together to determine the producer's total NPRP by-product revenue.

Oil Revenue – The *Monthly Production Statement* (**BC-S1**) provides us with the volume of oil produced from each NPRP well event. To determine a producer's oil revenue for an NPRP well event, we multiply the producer's oil sales price at the facility by the producer's share of oil produced.

We then add the oil revenue for each well event together to determine the producer's oil revenue for an NPRP project. We calculate the oil sales price from the producer's *Monthly Oil Sales Statement* (**BC-09**). In months when sales have not occurred, the price reported in a subsequent month is used to determine oil revenue for the well event.

Producer Payout Statement and Royalty Invoice

Payout Statement

If you have an interest in an approved NPRP project, we calculate and send you a monthly payout statement that reports balances and activity for each tier. The payout statement includes the opening payout account balance, project revenue, project cost, return on investment and the closing payout balance. The payout statement is included with your monthly royalty invoice that is sent to you around the tenth of each month.

The first payout statement you receive is for the project application month. For example, if a producer applies for the NPRP in June and receives approval in October, payout statements are produced starting with July.

We calculate your first statement using the original opening net allowed cost balance, which we determine from the information reported on the *Net Profit Historical Allowable Cost* (BC-50).

We use the payout balances in each tier to determine the tier of your project. Tier payout is reached when the closing balance in that tier reaches zero. We calculate the closing balance by adding the opening balance together with the net allowed costs and the return on investment. The opening balance is the closing balance from the previous month.

Please note: An NPRP project automatically advances to Tier 1 ten years after the first month of the project that oil or gas was produced from an NPRP well event.

The net allowed costs are the total of the monthly costs, as reported on the BC-51, minus the calculated net revenue. The reported costs are accumulated in the allowed cost balance and included in the monthly payout balance. We increase the costs reported by a project uplift factor of 10% for operating costs and 1% for capital costs.

If there is production from an NPRP well event, we begin to calculate your return on investment in the month following the project approval month. We do not calculate a return on investment for the project application month, or for the months leading up to, and including, the project approval month.

The rate we use to calculate the return on investment is the sum of the long term bond rate (LTBR) and the tier return on investment rate. The LTBR is the Government of Canada 10-year benchmark bond yield as published by the Bank of Canada. The return on investment rate is shown by tier in the table below.

Tier	Return on Investment Rate
Pre-payout tier	LTBR
Tier 1	LTBR + 25%
Tier 2	LTBR + 100%
Tier 3	Not applicable

We use the following formula to calculate the return on investment for each tier.

$$\text{Return on investment} = \frac{A + B}{2} \times \frac{C}{12}$$

A = opening net allowed cost balance
B = closing net allowed cost balance
C = return on investment rate

Example
The opening net allowed cost balance is $50,000,000 and the closing net allowed cost balance is $60,000,000.

The average net allowed cost balance is calculated as follows:

$50,000,000 + $60,000,000 = $110,000,000

$$\frac{\$110{,}000{,}000}{2} = \$55{,}000{,}000$$

The return on investment for each tier is calculated as follows:

Pre-payout tier

$$\frac{\$55{,}000{,}000 \times 5\%}{12} = \$229{,}166.67$$

The return on investment for pre-payout tier is $229,166.67.

Tier 1

$$\frac{\$55{,}000{,}000 \times 30\%}{12} = \$1{,}375{,}000$$

The return on investment for tier 1 is $1,375,000.

Tier 2

$$\frac{\$55{,}000{,}000 \times 105\%}{12} = \$4{,}812{,}500$$

The return on investment for tier 2 is $4,812,500.

Royalty Invoice

We send you an invoice for royalties around the tenth of each month. Royalty charges for an NPRP project are included on this invoice. Prior to project approval, royalties continue to be assessed under the ***Petroleum and Natural Gas Royalty and Freehold Production Tax Regulation***. The NPRP royalties begin the first month following the project approval month. The royalty rate for an approved NPRP project depends on the tier that the project is in.

Tier Royalty	
Pre-payout tier	2% of gross revenue
Tier 1	Greater of 5% of gross revenue and 15% of net revenue
Tier 2	Greater of 5% of gross revenue and 20% of net revenue
Tier 3	Greater of 5% of gross revenue and 35% of net revenue

We determine the gross revenue monthly. Gross revenue is equal to the sum of the values of the oil, marketable gas and natural gas by-products produced in a month. Net revenue is also determined monthly and is equal to the gross revenue for a month minus the eligible operating and capital costs incurred during the month. If the eligible operating and capital costs exceed revenue in a month after a project has reached tier 1, 2 or 3, the difference is carried forward to future months. An NPRP project cannot go back to a lower tier.

Included with your monthly royalty invoice, we send you a statement reporting an estimated allocation of royalties to each NPRP well event. The royalties are prorated to each well event based on the net revenue for each well event. This is an estimated allocation of royalties only and is intended to help you process the invoices. The actual royalty amount payable is determined at the project level. You must pay the actual amount of royalties within 15 days of receiving your monthly royalty invoice.

You must maintain a deposit for total oil and gas royalties payable. This deposit should include an amount for royalties for an NPRP project by the 25th day of the second month following a production month. You can adjust the deposit on a monthly basis to reflect any changes to royalties payable. This process is consistent with the current gas royalty payment schedule.

Need more info?

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The information in this bulletin is for your convenience and guidance and is not a replacement for the legislation.

Latest Revision
March 2015
- explained that after 10 years projects are automatically advanced to Tier 1