# Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version: HB 247
Fiscal Note Number:
() Publish Date:

Identifier: HB247-DOR-TAX-03-21-16
Title: TAX;CREDITS;INTEREST;REFUNDS;O & G
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: House Resources Committee

Department: Department of Revenue
Appropriation: Taxation and Treasury
Allocation: Tax Division
OMB Component Number: 2476

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

| | FY2017 Appropriation Requested | Included in Governor's FY2017 Request | Out-Year Cost Estimates | | | | |
|---|---|---|---|---|---|---|---|
| **OPERATING EXPENDITURES** | **FY 2017** | **FY 2017** | **FY 2018** | **FY 2019** | **FY 2020** | **FY 2021** | **FY 2022** |
| Personal Services | | | | | | | |
| Travel | | | | | | | |
| Services | | | | | | | |
| Commodities | | | | | | | |
| Capital Outlay | | | | | | | |
| Grants & Benefits | | | | | | | |
| Miscellaneous | | | | | | | |
| **Total Operating** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |

**Fund Source (Operating Only)**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| None | | | | | | | |
| **Total** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |

**Positions**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Full-time | | | | | | | |
| Part-time | | | | | | | |
| Temporary | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Change in Revenues** | | *** | *** | *** | *** | *** | *** |

**Estimated SUPPLEMENTAL (FY2016) cost:** 0.0 *(separate supplemental appropriation required)*
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2017) cost:** 1,500.0 *(separate capital appropriation required)*
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? yes
If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17

**Why this fiscal note differs from previous version:**

Revised to conform to propsed changes in the Work Draft Committee Substitute version "P" adopted by the House Resources Committee on March 19. The companion OGTCF-FUNDCAP fiscal note is also being revised at this time.

Prepared By: Ken Alper, Director | Phone: (907)465-8221
Division: Tax Division | Date: 03/21/2016 11:00 AM
Approved By: Jerry Burnett, Deputy Commissioner | Date: 03/21/16
Agency: Department of Revenue

**STATE OF ALASKA** **BILL NO.** CS HB247(RES)\P
**2016 LEGISLATIVE SESSION**

## Analysis

**Bill Background**
This legislation is a comprehensive attempt to reform and reduce the cost of Alaska's current program of providing direct tax credit rebates and other advantages to oil and gas companies. Various credits have been added to statute since 2003, with state repurchase beginning in 2007. Through the end of FY 2015, about $7.4 billion in tax credits were received by companies. This includes both credits used against tax liability and credits repurchased by the state; it also includes activity on both the North Slope and other areas of the state.

A substantial number of companies rely on these credits to support and subsidize their Alaska operations. Currently, in many cases the state is paying 55%-65% of the cost of a project during the development phase, and up to 85% of exploration costs. These large numbers result from "stacking" multiple credits. With the transition towards a system based mostly on operating loss credits, and the repeal or reduction of the expenditure credits that are stacked with those loss credits, the state's contribution towards many projects will be reduced roughly by half.

There are several themes, or goals, of this legislation as originally introduced. These include:

* Reduce the state's annual cash outlay
* Protect Net Operating Loss credits especially for exploration activity
* Limit repurchases to companies who need the support
* Strengthen the minimum tax and prevent abuses to the system
* Be more open and transparent
* Honor and pay credits earned to date and through any transition period.

To address the final bullet point, above, this legislation envisions a fund capitalization appropriation to cover any tax credits earned through the effective date. As originally introduced, this would have covered the last of the credits that would have been paid in FY 2016 if not for the $500 million limit established by the governor's line-item veto, all estimated credits that would be paid in FY 2017, and credits earned in the first part of calendar year 2016 before the effective date of the bill. The transition funds will total nearly $1 billion.

As amended, the fund capitalization will be adequate to cover all anticipated costs through FY17 but will require additional appropriation for FY18 and beyond. Although the narrative of this fiscal note describes all changes in the bill, only the "revenue" changes are captured on the first page. The reduction in state spending due to changes in this bill are captured in the "Oil and Gas Tax Credit Fund FUNDCAP" fiscal note.

**Summary of Fiscal Impact**
An earlier version of this fiscal note described DOR's estimate for this legislation as originally introduced. With the revisions proposed in the committee substitute, we anticipate a fiscal impact of $45-$60 million per year beginning in FY17. Of this, nearly all will be saved through reduced operating budget expenditures. Only a small indeterminate amount would come from increased revenues, due to the restoration of compound interest for assessed delinquent taxes.

The savings occur because some tax credit certificates would be smaller or would no longer be earned due to the repeal and reduction of certain specific credits as well as the closing of certain loopholes.

## Analysis Continued

**Implementation Cost**
The changes anticipated in this bill will require somewhat substantial reprogramming of the Tax Revenue Management System and Revenue Online tax portal. We have requested an estimate from the software developer, and currently assume a one-time cost of about $1,500,000 to accomplish this. We do not anticipate any additional costs to administer the tax program.

There will also be a need for substantial amendments to existing regulations to fully implement the changes.

**Detail of Specific Provisions**
**1) Repeal of certain credits and closing of loopholes**
The committee substitute reduces the Well Lease Expenditure Credit (AS 43.55.023(l)) from 40% to 30% in 2017 and 20% in 2018. This credit, and the 20% Qualified Capital Expenditure Credit (AS 43.55.023(a)) are repealed in 2022 in anticipation of the sunset of the existing "Cook Inlet Tax Caps" and a new tax regime for Cook Inlet. Also in 2017, the Carried Forward Annual Loss (or "New Operating Loss," AS 43.55.023(b)) credit is reduced from 25% to 10% for areas outside the North Slope.

The net effect of these changes will be to reduce state contribution for new projects from the current 45-65% range to 30% beginning in 2018. Companies who do not have an operating loss will remain eligible to receive the Capital and Well credits. This would continue to provide cash support to potentially profitable companies who, due to existing tax caps, effectively pay no production taxes.

The bill also eliminates a loophole that enables companies who have production of "new oil" on the North Slope but also claim a net operating loss. With the changes, companies will no longer be able to use a Gross Value Reduction to increase the size of a net operating loss credit. Current law can result in situations where the credit received can be greater than 100% of a company's actual loss.

It also eliminates another loophole that has been used by municipal utilities who also own oil or gas production. If a portion of that production is sold to an outside party, the proposed change ensures that these entities are only able to deduct or claim a pro-rated portion of their lease expenditures for the purpose of applying for credits.

**2) Deferral or loss of eligibility for credit repurchase**
Currently any company with less than 50,000 bbl / day of production in Alaska is eligible to have tax credit certificates repurchased by the state without limit, subject to appropriation. This legislation adds an additional restriction to repurchase, so that no single company can receive more than $200 million per year in state cash repurchases. Although this would not have any impact based on currently forecasted activity, it provides an element of protection from very large "outlier" projects that could otherwise result in multibillion dollar state credit liability in advance of production.

**3) Other changes**
Additionally, the bill restores quarterly compound interest for delinquent taxes, underpayments, and tax assessments. Current statute has included simple interest since 2014, which is believed to be an inadvertent amendment made in SB21.

The committee substitute also repeals several older and currently unused exploration incentive credit programs, and authorizes the Department of Revenue to use credit certificates to offset a company's other obligations to the state prior to repurchase. It also establishes a legislative working group to review the state's tax structure for Cook Inlet and other areas outside the North Slope, to provide recommendations to the legislature for consideration in 2017.