Fiscal Note

State of Alaska
2016 Legislative Session

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

Identifier: HB247CS(RLS)-DOR-TAX-05-01-16
Title: TAX;CREDITS;INTEREST;REFUNDS;O & G
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: House Rules 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	0.0		5,000.0	12,500.0	100,000.0	100,000.0	122,500.0

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

Estimated CAPITAL (FY2017) cost: 1,200.0 *(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If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17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:

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Division: Tax Division
Date: 04/30/2016 01:00 PM
Approved By: Jerry Burnett, Deputy Commissioner
Date: 05/01/16
Agency: Department of Revenue

STATE OF ALASKA
2016 LEGISLATIVE SESSION

BILL NO. HB247

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 2016, about $8 billion in tax credits will be 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. For work done in 2015, 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 state support through deductible lease expenditures, the state's contribution towards many projects will be reduced by 50% or more.

The Administration identified several themes, or goals, of this legislation as originally introduced. These include: (1) Reduce the state's annual cash outlay; (2) Protect Net Operating Loss credits especially for exploration activity; (3) Limit repurchases to companies who need the support; (4) Strengthen the minimum tax and prevent abuses to the system; (5) Be more open and transparent; and (6) Honor and pay credits earned to date and through any transition period. To address this final point, this legislation envisions a fund capitalization appropriation to cover any tax credits earned through the effective date. Savings due to reductions in future appropriations needed to repurchase tax credits will be captured in the separate fund capitalization fiscal note.

Summary of Fiscal Impact
With the revisions proposed in the Rules Committee substitute, we anticipate additional revenue of up to $122.5 million per year over the time period contained in the fiscal note. No additional revenue is expected in FY17, due to the phased implementation of various bill provisions, and the expectation that major producers will be able to apply credits earned prior to the effective date of this bill against tax payments in FY17-19.

Once fully implemented, the majority of the revenue impacts from this bill for the North Slope will be due to the strengthening of the so-called minimum tax "floor," via elimination of the net operating loss credits that can now be applied against a tax liability. Instead, companies would be required to carry forward lease expenditures to a future tax liability. In the Cook Inlet, the revenue impacts from this bill will be due to elimination of the net operating loss, capital expenditure, and well lease expenditure credits; companies in the Cook Inlet will also not be allowed to carry forward lease expenditures.

A small indeterminate amount of additional revenue would come from the restoration of compound interest and an increase in the interest rate for assessed delinquent taxes.

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 received a preliminary estimate from the software developer, which allows us to reduce our one-time cost to about $1,200,000 to accomplish these changes. 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.

Analysis Continued

Detail of Specific Provisions

1) Repeal of certain credits and closing of loopholes

For areas outside the North Slope (Cook Inlet and Middle Earth), the Rules committee substitute eliminates the Well Lease Expenditure Credit effective 1/1/17. The Qualified Capital Expenditure Credit is increased from 20% to 30% for 2017, then returns to 20% for 2018, then is eliminated effective 1/1/19. Additionally, the Carried Forward Annual Loss (or "Net Operating Loss") credit is eliminated effective 1/1/18. The net effect of these changes will be to reduce state contribution for new Cook Inlet projects from the current 45-65% range to zero beginning in 2019. However, this bill creates a legislative working group and envisions crafting a new Cook Inlet tax regime to take effect in 2019.

For the North Slope, the Rules committee substitute eliminates the Carried Forward Annual Loss credit effective 1/1/17 with a 3-year transition period for companies with production in 2016 and less than 20,000 barrels per day of production. After 1/1/17 (or the 3-year transition period), a company may carry forward any lease expenditures that exceed their Gross Value at Point of Production, and apply those in calculating a subsequent year's tax liability. Unlike the current credits, these carry forward lease expenditures could not be used to reduce a tax payment below the minimum tax; however other credits could still be used to reduce a tax payment below the minimum tax.

Although we are not forecasting changes to behavior in this analysis, it is reasonable to expect that certain companies who are years from production and tax liability may be less inclined to make investments given the state's reduced support for those investments and the reduced ability to monetize what support remains.

The bill also eliminates a provision of current law that enables companies having production of "new oil" on the North Slope and also claiming a net operating loss to use a Gross Value Reduction to increase the size of a net operating loss credit. 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 bill adds an additional restriction to repurchase, so that no single company can receive more than $85 million per year in state cash repurchases. Although this would not have any impact based on currently forecasted activity and other provisions of this bill, it provides an element of protection from large "outlier" projects that could otherwise result in large state credit liability.

3) Other changes

In the CS, the "gross value reduction" for new oil only applies for the first ten years of production, and is lost on 1/1/26 for fields currently receiving that reduction. 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 interest rate is increased from 3% above the federal discount rate to 5% above.

There is a small extension to a Frontier Areas exploration credit to enable wells in-process on 7/1/17 to be completed under the program before it sunsets. 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.

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2016 LEGISLATIVE SESSION

BILL NO. HB247

Analysis Continued

Fiscal Detail of CSHB247(RLS)\M (Revenue and Budget Impacts)

Revised 4-30-16 by Department of Revenue

CSHB247(RLS) \M

Provisions in CSHB 247 (RLS) and their Estimated Fiscal Impact as compared to Spring 2016 Forecast ($millions) - FORECAST PRICE[1]

Note: this table attempts to value the impact of each of the items independently, except where noted. In some cases, the total value of several impacts will not equal the sum of the individual impact values.

Brief Description of Provision - Includes only provisions anticipated to have a direct fiscal impact	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
1. Cook Inlet changes: The net operating loss credit is eliminated effective 1/1/18. The QCE and well lease exp credits are replaced with a 30% transition credit effective 1/1/17, a 20% transition credit effective 1/1/18, and zero credits effective 1/1/19.	$0	$0-$10	$10-$15	$10-$15	$10-$15	$30-$40	$30-$40	$30-$40	$30-$40
2. North Slope changes: The net operating loss credit for North Slope is eliminated effective 1/1/17; lease expenditures not used in a calendar year may be carried forward effective 1/1/17; 3-year transition period for refunds for companies with production in 2016 and less than 20,000 barrels per day of production. GVR cannot be used to create or increase a net operating loss.	$0	$0	$0	$75-$100	$75-$100	$75-$100	$40-$60	$40-$60	($10)-$0
3. GVR-eligible production qualifies for the GVR for a period of 10 years or until 1/1/26.	$0	$0	$0	$0	$0	$0	$0	$0	$0
4. The interest rate on delinquent taxes is changed to 5% above the Fed Res Discount rate, compounded quarterly	Indeterminate								
5. A tax exempt entity may earn credits applicable to only those lease expenditures subject to tax	Indeterminate								
Total Revenue Impact	$0	$0 to $10	$10 to $15	$85 to $115	$85 to $115	$105 to $140	$70 to $100	$70 to $100	$20 to $40
A. Budget impact of change in net operating loss credits, and QCE/WLE credits for Cook Inlet (provision 1 above)	$0	$0-$10	$20-$30	$40-$50	$100-$125	$100-$125	$75-$100	$75-$100	$75-$100
B. Budget impact of change in net operating loss credits, lease expenditures applicability, and GVR calculation for North Slope (provision 2 above)	$0	$40-$60	$125-$150	$100-$125	$100-$125	$100-$125	$125-$150	$125-$150	$125-$150
C. Budget impact of exploration credit extension for well spudded by 7/1/16	($5)-$0	($5)-$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of GVR applying to fields for a period of 10 years (provision 3 above)	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Budget Impact	($5) to $0	$35 to $70	$145 to $180	$140 to $175	$200 to $250	$200 to $250	$200 to $250	$200 to $250	$200 to $250
Total Fiscal Impact - does not include revenue impacts from potential changes in investment[2]	**($-5) to $0**	**$35 to $80**	**$155 to $195**	**$225 to $290**	**$285 to $365**	**$305 to $390**	**$270 to $350**	**$270 to $350**	**$220 to $290**
Non-refundable carry-forward credits balance at fiscal year end - current law[3]	$618	$751	$732	$585	$265	$136	$59	$0	$0
Non-refundable carry-forward credits balance (or equivalent) at fiscal year end - proposed[3]	$708	$947	$952	$950	$877	$859	$860	$896	$941
Change in year-end balance due to bill	**$90**	**$196**	**$220**	**$365**	**$612**	**$723**	**$801**	**$896**	**$941**

[1]The impacts listed are based on production and prices and company investment as forecasted in DOR's Spring 2016 revenue forecast. The forecasted oil prices are between $38.89 and $65.90.

[2]NOTE: "Total Fiscal Impact" includes best estimates of both revenue and operating budget impacts.

[3]These rows include estimates of carried-forward credits, and carried-forward lease expenditures, for previous calendar years, plus estimates of credits and carried-forward lease expenditures that will be earned on activity through June 30 of the fiscal year. For carried-forward lease expenditures, the balance shown is the credit-equivalent value of those expenditures assuming a 35% tax rate (for example, $100 million of carried-forward lease expenditures equate to $35 million of credits).

NOTE: The fiscal impact of this bill is an estimate based on the Spring 2016 revenue forecast. Estimates shown here are draft / preliminary based on our interpretation of possible changes. We reserve the right to make modifications to estimates for any forthcoming fiscal notes.