Fiscal Note

State of Alaska
2017 Legislative Session

Bill Version: HB 111
Fiscal Note Number:
() Publish Date:

Identifier: HB111-DOR-TAX-02-10-17
Title: OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS
Sponsor: RESOURCES
Requester: (H) RES

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)

	FY2018 Appropriation Requested	Included in Governor's FY2018 Request	Out-Year Cost Estimates				
OPERATING EXPENDITURES	**FY 2018**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**
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

1250 UGF Rev (UGF)	45,000.0		75,000.0	60,000.0	60,000.0	65,000.0	85,000.0
Total	**45,000.0**	**0.0**	**75,000.0**	**60,000.0**	**60,000.0**	**65,000.0**	**85,000.0**

Estimated SUPPLEMENTAL (FY2017) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2018) 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If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/18

Why this fiscal note differs from previous version:

Not applicable; initial version.

Prepared By: Ken Alper, Director
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Division: Tax Division
Date: 02/10/2017 02:00 PM
Approved By: Jerry Burnett, Deputy Commissioner
Date: 02/10/17
Agency: Department of Revenue

STATE OF ALASKA **BILL NO.** HB 111
2017 LEGISLATIVE SESSION

Analysis

Bill Background
This legislation would make multiple changes to Alaska's oil and gas production tax and tax credit statutes. 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 have been 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 2016, the producers earned credit certificates for up to 85% of the cost of the work.

According to the sponsors, this legislation builds on work done in 2016 with the passage of HB247. That bill was primarily focused on scaling back credits available in Cook Inlet. Those changes, combined with the sunset of most exploration credits that also occurred in 2016, reduces the state's estimates of future credit demand. Nevertheless, the volume of tax credit certificates eligible for state purchase continues to grow in part due to Governor Walker vetoing most of the FY2017 appropriation to the tax credit fund (AS 43.55.028). If annual appropriations continue according to the statutory formula, the current forecast indicates $1.6 billion in purchasable credits outstanding in 2026. Additionally, there have been several large discoveries recently announced on the North Slope; if any of these were sanctioned and built it could result in additional billions in credit liability that under current law could be payable far in advance of any additional tax or royalty revenue from the development.

With the changes made in this legislation, the state’s contribution towards many projects will be reduced, and most new credits will no longer be eligible for cash repurchase. Instead, companies would be expected to retain their credits until such time as they owe a tax liability to the state, at which time they could be used to offset the company's oil and gas production taxes.

Summary of Revenue Impact
The bill's fiscal impacts can be divided into two categories: increases to revenue (taxes), and reductions in the demand for tax credit repurchases (appropriations). The cover page table only includes the revenue items as it is impossible to predict future appropriations. Savings due to reductions in demand for future appropriations to purchase tax credits are noted in the summary table on page 4. In addition to the impact at forecasted oil prices, the bar charts on the bottom of page 4 also examine the average at a wide range of possible oil prices.

The initial revenue impact from this bill would be concentrated in changes to the minimum production tax. This is an alternative tax calculation to the standard "35% net tax less per-barrel credits." Taxpayers pay the higher of two calculations, the net tax as described above or 4% of the gross value at the point of production. Currently, the crossover point is at about $74 per barrel- at oil prices below that point the minimum tax tends to be used, and at higher prices the net tax is used. HB111 increases the minimum tax from 4% (at oil prices above $25) to 5% (at all prices). This would result in a tax increase at prices below the crossover, in the amount of $50-$75 million per year.

Additionally, HB111 prevents certain credits from being used to reduce tax payments below the minimum tax, a concept colloquially known as "hardening the floor." This will have a smaller revenue impact that disappears in future years as the price of oil increases. A further change reduces the per-taxable-barrel credit to a maximum of $5, from either $6, $7, or $8 at gross prices below $110. Because of the interaction of this tax feature with the minimum tax, the proposed change would only have a fiscal impact at oil prices between roughly $80 and $110 per barrel. This is seen in some of the later years in the fiscal note analysis.

Also, a small indeterminate amount of additional revenue would come from the elimination of the "zero interest rate" provision after three years of production tax delinquency.

Analysis

Implementation Cost
The changes anticipated in this bill will require somewhat substantial reprogramming of the Tax Revenue Management System and Revenue Online tax portal. Based on the required changes after the passage of HB247 in 2016, we currently assume a one-time cost of about $1,200,000 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) Reduces the Carried Forward Annual Loss Credit (also known as "NOL") rate for the North Slope from 35% to 15%, effective 1/1/18. This change would reduce the future liability from this credit by more than half. With the previous legislative changes and sunsets, the NOL is the major remaining credit on the North Slope.

2) Hardens the floor, so no credits can be used to reduce payments below the minimum tax. At extremely low prices, where major producers could have operating losses, this could result in up to $200 million in added revenue.

3) Increases the minimum tax rate from 4% (at prices above $25) to 5% (at all prices.)

4) NOLs will be no longer eligible for cash beginning in 2018. This change would not impact the credit certificates, estimated at about $900 million, that will be in company hands at the end of 2017 given no further action.

5) The amount of cash that each company can receive per year for repurchased credits is reduced to $35 million. This is currently $70 million with a “haircut” provision that makes it effectively $61 million. The haircut is repealed. Eligibility for state cash for credits is also limited to companies producing 15,000 barrels per day or less; this is reduced from 50,000.

6) Eliminates the $6, $7, and $8 per-barrel credit at wellhead prices between $80 and $110. The maximum production credit would be reduced to $5.

7) The Gross Value at the Point of Production for a given property can’t go below zero. This would only impact a very high tariff (likely remote) field at very low prices, so those fields could not have negative wellhead value that could offset other tax liability.

8) Eliminates the zero interest rate for delinquent taxes that currently take effect after three years of delinquency. This provision was added in HB247 to incentivize DOR to accelerate the tax audit process. However, the larger concern is that it remains in effect for the entirety of any tax appeal or litigation, reducing any incentive on the part of companies to settle a tax issue.

9) Limits the use of per-taxable-barrel credits to the month in which they were earned. This prevents the so-called "migrating credits" issue where per-barrel credits earned but unused in a month with oil prices under the minimum tax can be used to reduce taxes from a higher oil price month. This only has a revenue impact in a year with highly volatile oil prices.

FISCAL NOTE ANALYSIS

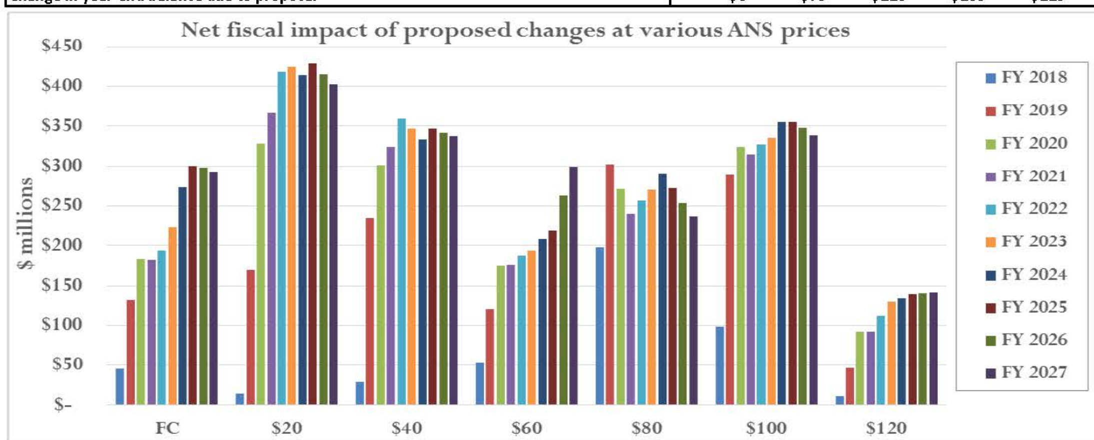
STATE OF ALASKA
2017 LEGISLATIVE SESSION

BILL NO. HB 111

Analysis

Provisions in HB 111 \O and their Estimated Fiscal Impact based on Fall 2016 Forecast ($millions) - Fall 2016 FORECAST PRICE Revised 2-9-17 by Dept. of Revenue

Description of Provision	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
1. Operating loss credit reduction from 35% to 15% effective 1/1/18 for North Slope.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
2. No credits can reduce tax below the minimum tax effective 1/1/18.	$20	$15	$0	$0	$0	$0	$0	-$10	-$25	-$5
3. Minimum tax increased to 5% of GVPP at all prices, effective 1/1/18.	$25	$75	$60	$60	$65	$65	$65	$60	$50	$50
4. No cash repurchase available for net operating loss credits based on expenses incurred after 1/1/18 (for purposes of this fiscal note, assumes all outstanding credits are funded in FY 2018).	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
5. State purchase of credits limited to $35 million per company per year, and only companies with less than 15,000 BTU-equivalent barrels of production, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
6. Per-taxable-barrel credits limited to maximum of $5 per barrel, effective 1/1/18.	$0	$0	$15	$20	$20	$45	$85	$105	$125	$135
7. Gross value at point of production (GVPP) cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
8. Interest on delinquent taxes continues to accrue after 3 years.	Indeterminate - likely positive for state.									
9. No true-up of excess per-taxable-barrel credits effective 1/1/18.	No impact under forecast - could benefit state if prices are volatile.									
Additional impact of implementing above provisions together vs standalone	$0	-$15	-$15	-$20	-$20	-$25	-$20	$0	$5	-$35
Total Revenue Impact	**$45**	**$75**	**$60**	**$60**	**$65**	**$85**	**$130**	**$155**	**$155**	**$145**
A. Budget impact of operating loss credit reduction from 35% to 15% effective 1/1/18 for North Slope.	$0	$25	$60	$65	$70	$75	$80	$80	$80	$80
B. Budget impact of No credits can reduce tax below the minimum tax effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
C. Budget impact of minimum tax increase effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
D. Budget impact of no cash repurchase for net NOL credits earned after 1/1/18.	$0	$45	$110	$120	$130	$140	$140	$145	$145	$145
E. Budget impact of new limits to credit repurchase eligibility, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
F. Budget impact of limiting per-taxable-barrel credits to $5 per barrel, effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
G. Budget impact of GVPP cannot go below zero effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
H. Budget impact of Interest on delinquent taxes continues to accrue after 3 years.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
I. Budget impact of No true-up of excess per-taxable-barrel credits effective 1/1/18.	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Additional impact of implementing above provisions together vs standalone	$0	-$10	-$50	-$65	-$70	-$75	-$75	-$80	-$80	-$80
Total Budget Impact	**$0**	**$60**	**$120**	**$120**	**$130**	**$140**	**$145**	**$145**	**$145**	**$145**
Total Fiscal Impact - (does not include potential changes in investment)	**$45**	**$135**	**$180**	**$180**	**$195**	**$225**	**$275**	**$300**	**$300**	**$290**
Non-refundable carry-forward credits balance at fiscal year end - current law	$14	$0	$0	$0	$0	$0	$0	$0	$0	$0
Non-refundable carry-forward credits balance at fiscal year end - proposed	$20	$75	$120	$155	$225	$305	$370	$440	$495	$550
Change in year-end balance due to proposal	**$6**	**$75**	**$120**	**$155**	**$225**	**$305**	**$370**	**$440**	**$495**	**$550**



NOTE: The fiscal impact of this proposal is an estimate based on the Fall 2016 revenue forecast. **Estimates shown here are draft / preliminary based on our interpretation of possible changes, and do not include any changes in company behavior as a result of this proposal. We reserve the right to make modifications to estimates for any forthcoming fiscal notes.**