Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version: HB 247
Fiscal Note Number:
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Identifier: HB247CS(FIN)-DOR-TAX-04-08-16
Title: TAX;CREDITS;INTEREST;REFUNDS;O & G
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: House Finance 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	20,000.0		90,000.0	90,000.0	95,000.0	145,000.0	210,000.0

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If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17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:

Revised to conform to changes in the Finance Committee Substitute. Also revised to include as a new baseline scenario the Final Spring 2016 Revenue Forecast. This document only includes the revenue raising numbers, with any program expenditure savings being captured in the companion FUNDCAP fiscal note offered by the Finance Committee.

Prepared By: Ken Alper, Director — Phone: (907)465-8221
Division: Tax Division — Date: 04/08/2016 10:00 PM
Approved By: Jerry Burnett — Date: 04/08/16
Agency: Department of Revenue

STATE OF ALASKA
2016 LEGISLATIVE SESSION

BILL NO. CS HB247(FIN)

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 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. 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 Finance Committee substitute, we anticipate additional revenue of $90 to $210 million per year over the time period contained in the fiscal note, with a smaller number in FY17 due to the mid-year effective date. Of this, the majority will due to the strengthening of the so-called minimum tax "floor," preventing certain credits from being used to reduce tax payments at low oil prices.be saved through reduced operating budget expenditures. Other revenues will come from certain production moving from the lower "new oil" regime to the higher "legacy oil" regime after five years of production. The current "tax cap" on Cook Inlet production is also repealed. A small indeterminate amount would come from the restoration of compound interest and an interest 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

The Finance committee substitute reduces the Cook Inlet 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 remaining "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 Cook Inlet. HIgher credit levels are retained in the so-called "middle earth" areas.

The net effect of these changes will be to reduce state contribution for new Cook Inlet projects from the current 45-65% range to 25% 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 $100 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 large "outlier" projects that could otherwise result in multibillion dollar state credit liability in advance of production.

3) Other changes

In the CS, the "gross value reduction" for new oil only applies for the first five years of production, and is lost on 1/1/21 for fields currently receiving that reduction. The Cook Inlet tax cap on oil, which is tied to the 2005 "ELF" rate of 0%, is repealed on 1/1/17.

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.

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Analysis Continued

Fiscal Detail of CSHB247(FIN)\F (Revenue and Budget Impacts)

Provisions in CSHB 247(FIN) \ F 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
1. The rate for net operating loss credits for Cook Inlet is changed to 10% for companies with a previous credit and zero for other companies.	$0	$0	$0	$0	$0	$0
2. The rate for QCE credits for Cook Inlet is changed to 10%; the rate for well lease exp credits for Cook Inlet is changed to 30% on 1/1/17 and then 20% on 1/1/18	$0	$0	$0	$0	$0	$10-$20
3. The tax limitation for Cook Inlet oil is repealed effective 1/1/17.	$0-$10	$0-$10	$0-$10	$5-$15	$10-$20	$15-$25
4. For North Slope, certain tax credits cannot reduce liability below 2% of GVPP effective 1/1/17.	$10-$20	$70-$100	$70-$100	$70-$100	$100-$150	$100-$150
5. The interest rate on delinquent taxes is changed to 5% above the Fed Res Discount rate, compounded quarterly	Indeterminate					
6. The GVR cannot be used to create or increase a net operating loss	$0	$0	$0	$0	$0	$5-$15
7. GVR-eligible production qualifies for the GVR for a period of 5 years or until 1/1/21.	$0	$0	$0	$0	$0-$10	$30-$50
8. A tax exempt entity may earn credits applicable to only those lease expenditures subject to tax	Indeterminate					
Total Revenue Impact	**$10-$30**	**$70-$110**	**$70-$110**	**$75-$115**	**$110-$180**	**$160-$260**
Budget impact of change in net operating loss credits for Cook Inlet (provision 1 above)	$0	$0-$10	$10-$20	$10-$20	$10-$20	$10-$20
Budget impact of change in QCE/WLE credits for Cook Inlet (provision 2 above)	$0	$15-$25	$15-$25	$15-$25	$45-$60	$45-$60
Budget impact of not allowing certain credits to reduce North Slope below 2% of GVPP (provision 4 above)	$0	$0	$0	$0	$0-$10	$0-$10
Budget impact of limiting refunds to $100 million per company/per project per year (only shifts timing of refunds)	Confidential due to limited use - net neutral as impact shifted to later years					
The GVR cannot be used to create or increase a net operating loss (provision 6 above)	0	$10-$20	$20-$30	$15-$25	$5-$15	$0-$10
Budget impact of exploration credit extention for well spudded by 7/1/16	($5)-$0	($5)-$0	$0	$0	$0	$0
Budget impact of GVR applying to fields for a period of 5 years (provision 7 above)	$0	$0	$0	$0	$0	$0
Total Budget Impact	**($5)-$0**	**$20-$55**	**$45-$75**	**$40-$70**	**$60-$105**	**$55-$100**
Total Fiscal Impact - does not include revenue impacts from potential changes in investment[2]	**$5-$30**	**$90-$165**	**$115-$185**	**$115-$185**	**$170-$285**	**$215-$360**

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Non-refundable carry-forward credits balance at fiscal year end - current law[3]	$618	$751	$732	$585	$265	$136
Non-refundable carry-forward credits balance at fiscal year end - proposed[3]	$676	$941	$1,065	$1,055	$957	$923
Change in year-end balance due to bill	**$58**	**$190**	**$333**	**$470**	**$692**	**$787**

[1]The impacts listed are based on production and prices as forecasted in DOR's Spring 2016 revenue forecast. The forecasted oil prices are between $38.89 and $61.64.

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

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.