FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

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Title	Cook Inlet Recovery Act	Dept. Affected:	Revenue
		RDU	Taxation and Treasury
		Component	Tax Division
Sponsor	Representative Mike Hawker		
Requester	(H) Resources	Component Number	2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
Personal Services	108.9	108.9	108.9	108.9	108.9	108.9	108.9
Travel	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Contractual	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Supplies	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**
CAPITAL EXPENDITURES	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CHANGE IN REVENUES ( )	***	***	***	***	***	***	***

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	117.3	117.3	117.3	117.3	117.3	117.3	117.3
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Interagency Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**

Estimate of any current year (FY2010) cost: 0.0

POSITIONS

Full-time	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**
Part-time	0.0	0	0	0	0	0	0
Temporary	0.0	0	0	0	0	0	0

ANALYSIS: *(Attach a separate page if necessary)*

HB 280 would make multiple changes to the existing law on tax credits and gas storage facilities. The portions of the bill that specifically apply to the Department of Revenue would change the treatment of credits under AS 43.55.023 (Qualifying Capital Expenditures) and create a credit against corporate income tax (CIT) for gas storage facilities (AS 43.20.046). The language relating to credits has the potential to be interpreted quite broadly with the potential for large reductions in state revenues when compared to future developments that might occur under the current law.

The Department is requesting a Corporate Income Tax Auditor III position (Range 22) to audit the tax credits and manage the approval, issuance and tracking of the new and modified state credits. (continued)

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Division: Tax Division — Date/Time 03-04-10; 4:27pm

Approved by: Ginger Blaisdell, Director — Date 03-07-10; 1:31pm
Administrative Services Division

(Revised 11/6/2009 OMB)

ANALYSIS CONTINUATION

There are three gas storage facilities currently operating in the Cook Inlet region. None of the existing gas storage facilities would qualify for the corporate income tax credits under this bill as currently written. However, it is unclear if the existing gas storage facilities could qualify for credits if they shut-down and re-opened or changed ownership. Any estimate of the change in revenues to the state under this legislation would be based on hypothetical development in the future. As a result, the full revenue impact of this legislation cannot be accurately determined at this time.

The following scenarios may provide some perspective on the range of potential revenue impacts.

Scenario 1: Corporate income tax credit effects on a small facility

The first scenario assumes the construction of a small gas storage facility in a depleted reservoir similar to one of the smaller currently operating gas storage facilities. The facility is assumed to be capable of approximately 1.25 cycles a year and to have a working gas capacity of approximately 1Bcf. Under the terms of HB 280 this facility would be entitled to a credit of $1.5 Million against state CIT.

In 2004, the Federal Energy Regulatory Commission (FERC) estimated the median cost-of-service rate for firm storage service at $0.64/Decatherm. One Decatherm is equal to one Mcf of natural gas if the natural gas contains 1,000 Btu/cubic foot. Escalating this cost for inflation produces a 2009 cost-of-service rate of approximately $0.72/Mcf of firm storage service.

Given the estimated cost-of-service, volume of gas cycled and reasonable assumptions about debt to equity and other factors, the Department of Revenue estimates that this gas storage facility would owe approximately $95,000/year in state CIT. This rough estimate suggests that the corporate income tax credit for gas storage created under AS 43.20.046 of this bill would entirely offset the state corporate tax liability for nearly the first 16 years of operation. It is important to note that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded.

There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $550,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $550,000 in refundable state credits. Additionally, under HB 280, the facility would be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations. There is also some question about whether the existing statute of limitations would allow the state to exercise the clawback provision.

Under this scenario the reduction in state taxes to the state is $1.5 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 2: Corporate income tax credit effects on a large facility

Scenario two assumes the construction of a large gas storage facility in a depleted reservoir. The facility is assumed to be capable of cycling approximately one time each year and to have a working gas capacity of

ANALYSIS CONTINUATION

Under the terms of HB 280 this facility would be entitled to the maximum credit of $30 million against state corporate income tax.

Using the same cost-of-service and financial assumptions as scenario one, the Department of Revenue estimates that the gas storage facility owner would owe approximately $1.5 million annually in state CIT. This rough estimate suggests that the corporate income tax credit created under AS 43.20.046 would completely offset the state corporate income tax liability for about 20 years of operation. It is important to note again that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded. There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $15,000,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $15,000,000 in refundable state credits. The facility would also be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations.

Under this scenario the reduction in state taxes to the state is $30 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 3: Broader interpretation of HB 280 benefits

Previous scenarios have assumed gas storage facilities operated at nearly 100% of capacity, using 100% of certified storage capacity. This scenario assumes a gas storage operator takes full economic advantage of a broad interpretation of the language in HB 280. Specifically, the facility uses a reservoir with a working gas capacity of 20 Bcf and the operator only cycles the minimum amount of gas to prevent the loss of the credits: 10,000 Mcf of natural gas annually. Using the same cost-of-service and financial assumptions as the previous two scenarios, the Department of Revenue estimates that the gas storage facility owner would owe less than $1,000 annually in state CIT. The storage facility owner would be eligible for a credit of $30,000,000 for the facility based on the working gas capacity. In this scenario it would take nearly 4,000 years of operation under this scenario for a gas storage operator to exhaust the state corporate income tax credit provided under this bill. Alternatively, after 10 years of commercial operation the owner could shut the facility down and retain $29,990,000 in refundable state credits.

Scenario 4: Lost or deferred production and production tax revenue

Previous scenarios have assumed gas storage in a depleted reservoir. It is possible that an oil and gas lessee could elect to shut-in production at a currently producing field earlier than would have otherwise occurred in order to take full advantage of plentiful native gas for free cushion gas. Under this bill the remaining native gas could be produced at the end of commercial operations for the gas storage facility. This deferred or lost production tax revenue would be in addition to lost revenue impacts equivalent to any of the previous three scenarios. The time value of deferred production is not calculated but could be substantial.

Scenario 5: Tax Ceiling

Existing state law provides the benefit of a tax ceiling for certain production under AS 43.55.011(j)(k) and (o). The tax ceiling applies to Cook Inlet production as well as any natural gas produced for use in state. Currently, credits earned under AS 38.05.180(i), AS 41.09.010, AS 43.55.024 or AS 43.55.025 are required to be applied first to a producers tax liability under AS 43.55.011(e) as though it were not limited by AS 43.55.011(j)(k) or (o).

ANALYSIS CONTINUATION

Under HB280, the limitation on application of credits does not apply to Cook Inlet production after January 1, 2011. This change would allow credits from Cook Inlet expenditures to also be applied to other non-Cook Inlet tax liability. In essence producers would earn credits and apply their full value against state wide tax liability and also receive the benefit of the reduced tax rate resulting from the comparison of actual tax rate (using those credits) and the prior ELF rate or ceiling rate. This repeal is likely to have the effect of reducing Cook Inlet tax collections to zero and allowing Cook Inlet credits to be used to shield taxes due from operations in other parts of Alaska such as the North Slope. This provision would be a particular benefit to companies operating in both Cook Inlet and on the North Slope.

Scenario five entails a producer with production in both Cook Inlet and on the North Slope. Assume the producer is entitled to a credit of $12 million under AS 43.55.025 because of Cook Inlet Exploration Expenditures, and assume that the producer's total production taxes are approximately $18 million, with $16 million attributed to North Slope production and $2 million attributed to Cook Inlet production.

Under existing law, AS 43.55.011(m) requires the producer to apply the $12 million in Cook Inlet credits to the full value of its hypothetical .011(e) Cook Inlet tax liability even though the Cook Inlet tax ceiling rate is applicable. Applying the $12 million credit against $2 million of .011(e) Cook Inlet production tax leaves $10 million in excess credits that may be used to offset tax liability elsewhere in the state. The tax ceiling rate on Cook Inlet oil is zero; therefore $2 million of the credit is considered "used" under AS 43.55.011(m).

Under current law, the North Slope tax liability of $16 million would be offset by the $10 million in credits left over after application of AS43.55.011(m), leaving a production tax liability of $6 million. Under HB 280, the producer would not have to draw down its $12 million of Cook Inlet tax credits, and instead be allowed to apply the full $12 million to the $16 million North Slope tax liability. As a result, the producer would pay a total of $4 million in production tax under this scenario, or $2 million less than under the existing law.

This scenario is a simplified version of how HB 280 might affect state revenues. Because AS 43.55.011(m) applies to multiple types of credits, and multiple taxpayers, the revenue effects could be significant.

Additional Scenarios and Fiscal Impacts:

The effect of increasing the value of credits for well work in Cook Inlet to 40% under AS 43.55.023(m) is not quantified in this analysis but would reduce tax revenues.

There could be additional reductions in state tax revenues if other existing facilities or natural gas pipelines were certified as gas storage and eligible for credits. This bill does not limit the credit for gas storage to the Cook Inlet, and in fact could be applied to gas stored on the North Slope or other areas of the state.

Cook Inlet production tax and additional production caused by the injection or withdrawal requirements under this proposal are very unlikely to generate more than a small fraction of the revenue that would be required to fund this credit. This means production taxes from other areas of the state, such as the North Slope would likely be the source of funds to the tax credit fund for the state to repurchase this credit.