FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **CSHB 308 \P**
() Publish Date:

Identifier (file name): CSHB308(RES)-REV-TAX-03-23-10
Title: Oil and Gas Production Tax
Sponsor: Representative Johnson
Requester: (H) Resources

Dept. Affected: Revenue
RDU: Taxation and Treasury
Component: Tax Division
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	247.0		247.0	247.0	247.0	247.0	247.0
Travel	6.0		6.0	6.0	6.0	6.0	6.0
Contractual	110.0		10.0	10.0	10.0	10.0	10.0
Supplies	1.0		1.0	1.0	1.0	1.0	1.0
Equipment							
Land & Structures							
Grants & Claims							
Miscellaneous							
TOTAL OPERATING	**364.0**	**0.0**	**264.0**	**264.0**	**264.0**	**264.0**	**264.0**
CAPITAL EXPENDITURES							
CHANGE IN REVENUES ( )	***	**0.0**	***	***	***	***	***

***** See Analysis Section for Additional Information *****

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF	364.0	0.0	264.0	264.0	264.0	264.0	264.0
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	**364.0**	**0.0**	**264.0**	**264.0**	**264.0**	**264.0**	**264.0**

Estimate of any current year (FY2010) cost: 0.0

POSITIONS

Full-time	**2.0**	0.00	2	2	2	2	2
Part-time							
Temporary							

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

See Attached.

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Date/Time: 03-23-10; 5:23pm
Approved by: Ginger Blaisdell, Director
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Date: 03-23-10; 7:34pm

(Revised 11/6/2009 OMB)

ANALYSIS CONTINUATION

Bill Language and Revenue Impacts:
*** We cannot currently make a determination of the revenue impacts of the bill. For this reason, asterisks are include in our revenue estimates for this fiscal note.

This bill makes changes to Alaska's oil and gas production tax as well as to the interest rate applied to most taxes levied by the state of Alaska. The main provisions of the bill and potential revenue impacts are discussed below:

1. Change in base on which progressive surcharge is multiplied. This bill would retain the rates used to calculate the progressive surcharge as specified in AS 43.55.011(g), but it would change the base on which the progressive surcharge is applied. Instead of applying the progressive surcharge rate to the entire production tax value, this bill would apply the progressive surcharge rate only to that portion of the production tax value that exceeds the progressivity trigger of $30 profit per barrel. The progressivity rate remains unchanged at 0.4% per $1 of production tax value over $30 per barrel, then 0.1% per $1 of production tax value over $92.50 per barrel.

Had this provision been in place in FY 2008, the state revenues would have been reduced by over $1 billion, or 15% of the tax revenue collected. In FY 2009, state revenues would have been reduced by $400 million , or close to 13%.

Using the Department of Revenue Fall 2009 forecasted prices, had this provision been in place for all of FY 2010, the state would have received $300 million less in production tax revenue, or 14%. With oil price increases in later years of the Fall 2009 forecast, this provision would result in revenue reductions of $400 million in FY 2011 and up to $622 million in FY 2015.

2. Add a special credit for qualified well-related expenditures. This bill would add a separate credit for well-related expenditures. The credit would be 30% of capital expenditures for well drilling or seismic exploration and analysis (taken in lieu of the 20% credit for capital expenditures per AS 43.55.023 or the 30% credit per AS 43.55.025), and during production, 30% of costs of operating wells and moving fluids to the wellhead.

Under current projected spending levels, revenues would be expected to be reduced by at least $325 million in FY 2011. Given the broad definition of well-related expenditures in this bill, the impact could potentially be even greater. The Department of Revenue provides an indeterminate fiscal impact to revenues past FY 2011 because the new incentives will likely spur higher spending levels on development activity, which would result in more credits being earned, but would also be expected to increase production, thus providing an offsetting increase in revenue.

3. Reduce the amount of time that auditors have to complete audits on production tax returns. This bill would reduce the timeframe for audits from 6 years to 3 years beginning with returns for the 2010 tax year. This provision would require additional costs for the Department which are described in the Expenses section below.

4. Waive interest for changes in production tax liability as a result of retroactive regulations changes. Following adoption of retroactive regulations to the oil and gas production tax under AS 43.55, the Department of Revenue is required to determine whether the retroactive application of the regulation caused an overpayment or underpayment of the amount due in tax. For an underpayment, interest is waived as long as the underpayment was due to the regulation and the producer made a good faith estimation and payment of its tax obligation under regulations in place when the payment was due. For an overpayment, interest does not accrue until either the first day of the second month following the regulation taking effect, or 90 days after the Department receives an amended annual production tax return with request for refund. The interest provisions are retroactive to February 2007. At this time it is uncertain whether there would be any revenue impact from this change, since it is unclear whether there was any underpayment or overpayment due to the retroactive regulations. The Department of Revenue does not include interest payments in revenue projections, therefore this change would not affect the current revenue forecast.

5. Eliminate requirement that capital credits be spread over two years. Producers and explorers receive a capital expenditure credit in the amount of 20 percent of the qualified capital expenditure, 25% of a loss carryforrward, and up to 40% of an exploration expenditure. This bill would remove the provision that no more than half of the tax credit may be applied for in a single calendar year. As a result, the entirety of credits could be applied in the year they are earned.

(continued on next page)

ANALYSIS CONTINUATION

The calculation of the revenue impact for this provision is difficult for two reasons: (1) the timing of the revenue impact will depend upon when the bill is signed into law; and (2) the amount the state may potentially be expected to pay to purchase credits is conditioned in part on removing the reinvestment requirement discussed in #6 below, and the timing of the payment will depend on whether companies will immediately seek reimbursement for their credits.

We assume for this provision a scenario where all credits held by companies with production tax liabilities are used in FY 2010 or FY 2011. This would cost the state approximately $225 million in reduced taxes between the two years.

For companies that are holding credit certificates and are not expected to incur a tax liability in FY 2010 or FY 2011, we estimate an additional liability of up to $150 million over previous expectations for the two fiscal years. These impacts could spill into FY 2012, should companies delay seeking reimbursement.

Beyond FY 2012, revenue impacts are expected to be negligible.

6. Remove reinvestment requirement for state purchase of capital credits. For companies applying for state purchase of capital credits, this bill would remove the requirement that the companies reinvest an amount equal to the amount of the credit purchased within 24 months after applying for a credit certificate.

This provision is expected to be revenue neutral as the credits will reduce revenue whether the state purchases the credits or other companies purchase and subsequently apply the credits against tax liabilities.

7. Change the rates for calculating interest for most tax types. This bill would change the way interest is calculated for most tax types administered by the Department of Revenue, including the production tax. Under current law, the interest rate is the greater of 11 percent or 5 percentage points above the discount rate at the 12th Federal Reserve Bank. Under this bill, the interest rate would be 3 percentage points above the discount rate. If this provision were in place today, the interest rate on taxes would fall from 11 percent to 3.75 percent.

The revenue reduction from this provision is indeterminate because the Department does not have a management information system capable of tracking interest for all taxes. Producing a revenue estimate would require manually compiling information from hundreds of tax returns. Since oil and gas settlements go to the Constitutional Budget Reserve Fund (CBRF), this provision would reduce revenue to both the general fund and the CBRF. This provision would require additional costs for the Department which are described below.

Expenses:
The change to reduce the amount of time that auditors have to complete production tax audits will have a direct fiscal impact on the Tax Division. Reducing the time the Audit Group has to complete audits by 3 years will require the hiring of 2 additional oil and gas auditor IV positions, costing the Division approximately $264,000 per year. If the positions are not filled timely, either the audits will not be completed in time, or the Division will be forced to make defensive tax assessments and shift the burden to its Appeals Group, which could require adding more appeals officers.

In addition, the changes in interest rates and other provisions of this bill would result in one-time costs of $100,000 in FY 2011 for changes to the accounting and tax examination system.

Effective Dates:
The effective date of the bill is immediate for all provisions except for four provisions as follows:
1. The change in progressivity is effective the month following the effective date of the other provisions in this bill.
2. The change in interest rates is effective the first day of the calendar quarter following the effective date of the other provisions of this bill .
3. The elimination of the credit split is effective January 1, 2010.
4. The elimination of the reinvestment requirement for state purchase of credits is effective January 1, 2010.

An immediate effective date would create an administrative burden for several provisions of the bill. In order to simplify revenue impacts, we assume that the progressivity and credit changes begin with FY 2011, on July 1, 2010.