

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: CSHB 519(O&G)
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Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Natural Gas Pipeline BRU Administration and Support
Special Provisions Component Office of the Commissioner
 Sponsor House Rules Committee
 Requester House Oil and Gas Committee Component No. 123

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	83.0	83.0				
Travel	30.0	30.0				
Contractual	250.0	250.0				
Supplies	5.0	5.0				
Equipment	6.0					
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	374.0	368.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()			(1,000.0)	(22,000.0)	(35,000.0)	(53,000.0)
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	124.0	118.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Statutorily Designated Receipts	250.0	250.0				
TOTAL	374.0	368.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

See attached pages.

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
 Division: Department of Revenue Date/Time 4/18/02 12:34 PM
 Approved by: Wilson Condon, Commissioner Date 4/18/2002
 Agency: Department of Revenue

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OVERVIEW

This legislation would reauthorize the Alaska Stranded Gas Development Act under AS 43.82. The act expired June 30, 2001, and this legislation would extend the application date for a project sponsor from June 30, 2001 to June 30, 2005.

The Stranded Gas Development Act, adopted by the 1998 Legislature, authorized the Commissioner of Revenue to negotiate a contract for payments in lieu of taxes with the developer of an LNG project to commercialize Alaska's North Slope natural gas reserves. No project sponsor applied under the act before it expired last year. The intent of the legislation was to provide a mechanism whereby the state could help promote commercialization of its natural gas reserves by structuring payments in lieu of taxes to help relieve the burden on a project sponsor in the early years, when cash flow is not positive, and in return receive a larger share of the revenues in later years after the project sponsor had recovered its heavy development costs. This also would allow the state to receive a greater share of the revenues in later years if gas prices increased.

The act allows for a negotiated contract for payments in lieu of one or some or all of the following taxes:

- Production taxes and surcharges
- Oil and gas production property taxes (state and municipal portions) under AS 43.56)
- Municipal property taxes
- Municipal special assessments
- Corporate income taxes
- Municipal sales and use taxes

This legislation (HB 519) also expands the definition of a qualifying project under the Stranded Gas Act to include a natural gas pipeline to serve markets outside Alaska. In addition, this legislation clarifies the definition of a qualifying LNG project to include one that serves Lower 48 states or overseas markets.

A negotiated contract would make it possible to tailor the fiscal arrangements to meet the needs of the proposed project while, at the same time, ensuring that the public benefits from the project. A set of arrangements providing for contractual payments in lieu of taxes could provide fiscal terms that potential investors will believe are likely to remain permanently in place over the life of the project.

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COST OF LEGISLATION

The fiscal note for this legislation includes the following costs and assumptions leading up to the costs:

- We assume the state would receive a project application early in Fiscal 2003.
- Negotiating the contract for payments in lieu of taxes would start immediately, and would be completed at the conclusion of the 2004 legislative session.
- Project construction would start in Fiscal 2005 and continue through Fiscal 2008.
- Natural gas production would start in Fiscal 2009.
- A special assistant to the commissioner would be hired for Fiscal 2003 and 2004 to coordinate the Department of Revenue's work with the project sponsor and the affected communities.
- Travel, supplies and equipment costs would be associated with the new position and with the department's overall effort to meet with the project applicant and officials of the affected communities.
- The contractual expenses would be incurred in two areas:
 1. Oil and gas economic and tax consultants to advise the department in negotiating with the project applicant and structuring a contract for payment in lieu of taxes that is both advantageous to the project and provides for a fair return to the state on the publicly owned resource.
 2. Additional consultants to help the department prepare socioeconomic impact studies on the affected communities, to be used in determining the financial needs of the communities and negotiating with the project applicant.

The cost of the new position, travel, contractual and supplies is requested from the general fund. That total is \$116,000 in Fiscal 2003 and \$110,000 in Fiscal 2004.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the department's evaluation of the project application and in developing terms of the contract could be reimbursed by the applicant. The statute allows the commissioner to condition the contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are \$250,000 each in Fiscal 2003 and Fiscal 2004.

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PROPERTY TAX WAIVER

Although the Stranded Gas Development Act calls for the commissioner to negotiate a contract for payments in lieu of taxes, including property taxes, Sections 4 and 5 of this legislation waive all state and municipal property taxes on the project during construction and the first two full years of project operation. This would be imposed upon the municipalities, which would not have any option in accepting or rejecting the property tax waiver.

The Department of Revenue believes it is premature to waive an estimated \$500 million in state and municipal property taxes without first determining if the tax relief would in fact be needed to make the project economical.

The Stranded Gas Act allows tax relief or deferral, but the explicit mandate of the Stranded Gas Act was to tailor the state's fiscal terms to the particular economics of the project and to maximize the benefit to the people of the state from the development. For example, the Stranded Gas Act enables the state to give tax relief where needed to make the project economic, but then recoup its foregone revenue — or more — when the project economics improved.

Under this bill, however, the state would get nothing in exchange for property tax relief. What happens if the price of gas goes up to \$5 or more per mcf? The project developers would profit enormously from the upside, and the state would lose out on sharing in that additional profit potential as “repayment” for any tax relief granted early in the development. Yes, the legislature could then raise taxes, but this is not the fiscal certainty that the state and potential project sponsors seek from this legislation.

The department strongly recommends a change in the property tax waiver provision of this legislation to (1) include an opportunity for the state to share in the potential benefits from a highly profitable project as part of the package for any tax relief, (2) provide an opportunity for the affected communities to participate in the tax relief discussions, and (3) a needs test for the tax relief.

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DECREASE IN STATE and MUNICIPAL REVENUES

Under Sections 4 and 5 of this legislation:

- The state would lose an estimated \$212 million in property tax revenues during construction and through the second full year of project operation.
- The Fairbanks North Star Borough and North Slope Borough would lose an estimated \$302 million in property tax revenues during construction and through the second year of production.
- Although the state and the municipalities would never receive this property tax revenue if the project is not built, there is no opportunity to determine whether the tax relief provided by this bill is needed to make the project economic.
- This bill does not provide a mechanism to provide funding to affected municipalities that experience additional costs because of the impact of the project on the community.
- The above estimates are based on a natural gas project carrying North Slope gas to Alberta, for distribution to markets in the Lower 48 states. The estimate of lost revenues would be different and would include additional municipalities if the project was an LNG line to tidewater at Valdez or Cook Inlet.
- The affected municipalities would face higher expenses during the influx of construction workers and the resulting demand for increased school, police, road and various other public services. Meeting those demands without the ability to tax the project itself would put a severe strain on local resources.
- One option for localities would be raise property taxes on all other property within their jurisdiction. The state's share of property taxes on the Trans-Alaska Oil Pipeline and other oil and gas facilities already in place is reduced dollar for dollar by property taxes paid to local communities. Therefore increased municipal property taxes in the affected municipalities would reduce the state's oil and gas property tax receipts.

Section 7 of this legislation would exempt the natural gas project from municipal sales and use taxes. The department is unable to estimate the fiscal impact of this provision on municipalities.