Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version:	SCS 2d CSHB 247(FIN)
Fiscal Note Number:	8
(S) Publish Date:	5/17/2016

Identifier: HB247SCS(FIN)-DOR-TAX-05-17-16
Title: TAX;CREDITS;INTEREST;REFUNDS;O & G
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: Senate 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	0.0		10,000.0	12,500.0	12,500.0	12,500.0	(17,500.0)

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If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17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 Senate Finance Committee Substitute as introduced on 5/17/16. The cover page of this document only includes the revenue raising numbers, with any program expenditure savings noted in the detailed impact table attached within the narrative section.

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Division: Tax Division
Date: 05/17/2016 01:00 PM
Approved By: Jerry Burnett, Deputy Commissioner
Date: 05/17/16
Agency: Department of Revenue

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2016 LEGISLATIVE SESSION

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 changes made in this legislation, the state's contribution towards many projects will be reduced by 50% or more.

The Administration identified several themes, or goals, of this legislation as originally introduced. These include: (1) Reduce the state's annual cash outlay; (2) Protect Net Operating Loss credits especially for exploration activity; (3) Limit repurchases to companies who need the support; (4) Strengthen the minimum tax and prevent abuses to the system; (5) Be more open and transparent; and (6) Honor and pay credits earned to date and through any transition period. Savings due to reductions in future appropriations needed to repurchase tax credits are noted in the summary table on page 4 of this fiscal note.

Summary of Revenue Impact
The current version of the bill is a substantial revision to what passed the House of Representatives on 5/13. With these changes, we anticipate additional revenue of up to $12.5 million per year over the time period contained in the fiscal note. No additional revenue is expected in FY17, due to the phased implementation of various bill provisions.

Once fully implemented, the majority of the revenue impacts from this bill for the North Slope will be due to the phaseout and elimination of the three major credits (NOL, QCE, and WLE) in Cook Inlet. Some of these credits are sued to reduce tax payments, thus reducing these credits will increase revenue in addition to reducing credit repurchases. Additional revenue is due to the addition of a $1 per barrel tax on oil produced in Cook Inlet. The fiscal note shows a revenue reduction beginning in 2022 as the existing "Cook Inlet tax caps" are no longer sunsetting in that year. On the North Slope, additional revenue will result from the inability to use the Gross Value Reduction (GVR) for "new" oil to increase the size of a Net Operating Loss credit.

Also, a small indeterminate amount of additional revenue would come from the restoration of compound interest and an increase 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. This $1.2 million is in the current version of the FY2017 capital budget, SB138.

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

For Cook Inlet and Middle Earth, the House amended bill reduces the Qualified Capital Expenditure (QCE) credit on 1/1/17 and eliminates it on 1/1/18. The carried forward annual loss (NOL) credit is reduced to 15% in 2017 and is sunset in 2018. The Well Lease Expenditure Credit (WLE) is reduced to 20% in 2017 and sunset in 2018. The net effect of these changes will be to reduce state contribution for new Cook Inlet projects from the current 45-65% range to zero beginning in 2018. Unlike prior versions of the bill, this version does not create a legislative working group for a new Cook Inlet tax regime. Instead, the current tax cap, averaging 17.5 cents on Cook InLet gas and gas used in state, is extended indefinitely. A new tax, not to exceed $1 per barrel, is added for Cook Inlet oil.

The bill also eliminates a provision in current law that enables companies having GVR-eligible "new oil" production on the North Slope and also claiming a net operating loss to use the GVR to increase the size of an NOL credit. 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

For the North Slope, the Senate Finance revisions keep the $70 million per-company cap on annual credit certificate repurchases. However, only the first half of any certificate is repurchased at full face value and the second half may only be purchased at 75% of face value. Alteratively, a company can choose to carry the second half forward into a future year. Operating losses for larger companies continue to be carried forward against future taxes, with the NOL credit rate retained at 35%.

3) Other changes

In this version, the GVR for new oil only applies for the first seven years of production, and is lost on 1/1/23 for fields receiving it before the effective date. The GVR can be terminated early if the price of oil exceed $70 for three years of production. Additionally, the bill restores quarterly compound interest for delinquent taxes, underpayments, and tax assessments for the first four years of a delinquency. The interest rate for delinquent production taxes is increased from 3% above the federal discount rate to 7% above, but only for the first three years of a delinquency. After three years, the interest rate is zero. The bill adds a surety bond to protect a producer's unsecured creditors.

The finance 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.

There is a prioritization of credits, given limited funds, for companies with greater than 75% Alaska resident hire.

The bill also reduces the Refinery Infrastructure Credit from 40% to 20% in 2017, and sunsets it in 2018. In current law this was scheduled to sunset in 2020.

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BILL NO. HB 247

Analysis Continued

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

Revised 5-17-16 (version 4) by Department of Revenue

Preliminary SCS HB247(FIN)

Provisions in preliminary SCS HB247(FIN) 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 QCE credits for Cook Inlet and Middle Earth are reduced to 10% on 1/1/17 then eliminated 1/1/18; the well lease exp credits for Cook Inlet and Middle Earth are reduced to 20% on 1/1/17, then eliminated 1/1/18; the NOL credits for Cook Inlet and Middle Earth are reduced to 15% on 1/1/17 then eliminated 1/1/18.	$0	$0-$5	$10-$15	$10-$15	$10-$15	$30-$40
2. Sunset removed for Cook Inlet tax caps on gas; for oil, sunset removed and tax limitation changed from zero to $1 per barrel of oil effective 1/1/17 (represents additional revenue to provision #1).	$0	$0-$10	$0-$10	$0-$10	$0-$10	($75)-($50)
3. The GVR cannot be used to create or increase a net operating loss	$0	$0	$0	$0	$0	$5-$15
4. GVR-eligible production qualifies for the GVR for a period of 7 years; benefit ends early if average ANS price exceeds $70 for any 3 years of production.	$0	$0	$0	$0	$0	$0
5. The interest rate on delinquent taxes is changed to 7% above the Fed Res Discount rate, compounded quarterly for the first three years, then to zero interest thereafter.	Indeterminate					
6. A tax exempt entity may earn credits applicable to only those lease expenditures subject to tax	Indeterminate					
Total Revenue Impact	$0	$0 to $15	$10 to $25	$10 to $25	$10 to $25	($40) to $5
A. Budget impact of changes to Cook Inlet credits (provision 1 above)	$5-$15	$25-$45	$40-$60	$40-$60	$75-$100	$75-$100
B. Budget impact of changes to tax caps for Cook Inlet (provision 2 above)	$0	$0	$0	$0	$0	$0
C. For credits paid after 1/1/17, limit refunded credits to $70 million per company per year. Half of credits are paid at full value and half are paid at 75% of value. *(Fiscal impacts assume all companies receive maximum refunds each year and are after other credit provisions of bill)*	$0	$50-$60	$35-$45	$20-$30	$15-$25	$15-$25
D. The refinery credit under AS 43.20 is reduced to 20% of eligible expenditures on 1/1/17 then eliminated on 1/1/18.	$0	$0	$5	$15	$20	$10
E. The GVR cannot be used to create or increase a net operating loss (provision 3 above)	$0	$10-$20	$20-$30	$15-$25	$5-$15	$0-$10
F. Budget impact of GVR applying to fields for a period of 7 years or less (provision 4 above)	$0	$0	$0	$0	$0	$0
Total Budget Impact[2]	$5 to $15	$85 to $125	$100 to $140	$90 to $130	$115 to $160	$100 to $145
Total Fiscal Impact - does not include revenue impacts from potential changes in investment[3]	**$5 to $15**	**$85 to $140**	**$110 to $165**	**$100 to $155**	**$125 to $185**	**$60 to $150**
Non-refundable carry-forward credits balance at fiscal year end - current law[4]	$618	$751	$732	$585	$265	$136
Non-refundable carry-forward credits balance at fiscal year end - proposed[4]	$610	$720	$680	$510	$260	$130
Change in year-end balance due to bill	-$8	-$31	-$52	-$75	-$5	-$6

[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.

[1]This proposal stipulates that credits can only be earned for expenditures to carry out a DNR approved Plan of Development; our analysis assumes that all expenditures in forecast would qualify.

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

[4]These rows include estimates of carried-forward credits for previous calendar years, plus estimates of credits that will be earned on activity through June 30 of the fiscal year.

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.