

Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version:	CSSB 130(RES)
Fiscal Note Number:	3
(S) Publish Date:	4/13/2016

Identifier: SB130CS(RES)-DOR-TAX-04-13-16
 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	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2017 Request	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
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	10,000.0		55,000.0	75,000.0	70,000.0	120,000.0	125,000.0
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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 If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17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 amendments made in the Senate Resources Committee to the governor's original version. Baseline scenario assumes the Final Spring 2016 Revenue Forecast. The cover sheet of this document only includes the revenue raising numbers, with any program expenditure savings noted in the detail table on p. 4.

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Division:	Tax Division	Date:	04/13/2016 04:00 PM
Approved By:	Jerry Burnett, Deputy Commissioner	Date:	04/13/16
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 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 Senate Resources Committee substitute, we anticipate additional revenue of -\$15 to \$40 million per year over the time period contained in the fiscal note, with the changes concentrated in the last two years of the period. Revenue reductions in 2022 result in the zero tax rate in Cook Inlet as the statutory tax caps are scheduled to sunset. Positive revenues will come from certain production moving from the lower "new oil" regime to the higher "legacy oil" regime after five years of production. A small indeterminate amount would come from the restoration of compound interest and an interest in the interest rate for assessed delinquent taxes.

Budget reduction impact of \$0 to \$140 million per year over the period of the fiscal note is due to the credit reductions, primarily in Cook Inlet, described in the detail of specific provisions on the next page.

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 Resources committee substitute reduce Cook Inlet credits for Net Operating Losses (AS 43.55.023(b)) from 25% to 15% in 2017, and to zero in 2018. The Qualified Capital Expenditure credit (AS 43.55.023(a)) is reduced from 20% to 10% in 2017, and to zero in 2018. The Well Lease Expenditure credit (AS 43.55.023(l)) is reduced from 40% to 20% in 2017 and to zero in 2018. "Middle Earth" credits will remain at the 2017 Cook Inlet levels.

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%-35% in 2017 and zero in 2018. A tax rate of zero for oil and gas production in Cook Inlet is also imposed in 2018, along with elimination of the current ELF-based "tax caps."

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 \$85 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 very large 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.

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 7% above for the first three years a tax is delinquent, going to zero interest thereafter.

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 priority for companies with greater than 75% Alaska Hire in event that the available funds in the Oil and Gas Tax Credit Fund is inadequate to meet the demand.

Analysis Continued

Revised 4-12-16 by Department of Revenue

Provisions in CSSB 130(RES) and their Estimated Fiscal Impact as compared to Spring 2016 Forecast (\$millions) - FORECAST PRICE¹

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	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 15% effective 1/1/17, then to 0% on 1/1/18 (modeled separately from items 2 and 3).	\$0	\$0	\$0	\$0	\$0	\$0
2. The rates for QCE credits and WLE credits for Cook Inlet are changed to 10% and 20%, respectively, on 1/1/17, then to 0% for both on 1/1/18 (modeled separately from items 1 and 3).	\$0-\$5	\$0-\$5	\$10-\$15	\$10-\$15	\$10-\$15	\$30-\$40
3. Cook Inlet tax caps are repealed and a tax rate of 0% for Cook Inlet oil and gas is implemented effective 1/1/18 (modeled separately from items 1 and 2).	(\$5)-\$0	(\$5)-\$0	(\$5)-\$0	(\$5)-\$0	(\$5)-\$0	(\$50)-(\$25)
4. 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	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate
5. The GVR cannot be used to create or increase a net operating loss.	\$0	\$0	\$0	\$0	\$0	\$5-\$15
6. GVR-eligible production qualifies for the GVR for a period of 5 years or until 1/1/21.	\$0	\$0	\$0	\$0	\$0	\$30-\$50
7. A tax exempt entity may earn credits applicable to only those lease expenditures subject to tax	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate
8. Special tax treatment for qualifying "gas used in state" outside of Cook Inlet eliminated on 1/1/18 (currently tied to Cook Inlet gas ceiling)	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate
Total Revenue Impact (does not include provisions 1-2)	(\$5)-\$0	(\$5)-\$0	(\$5)-\$0	(\$5)-\$0	(\$5)-\$10	(\$15)-\$40
A. Budget impact of change in net operating loss credits for Cook Inlet (provision 1 above)	\$0	\$5-\$10	\$10-\$20	\$10-\$20	\$10-\$20	\$10-\$20
B. Budget impact of change in QCE/WLE credits for Cook Inlet (provision 2 above)	\$5-\$10	\$30-\$40	\$30-\$40	\$30-\$40	\$75-\$100	\$75-\$100
C. Budget impact of change in net operating loss, QCE, and WLE credits for Middle Earth effective 1/1/17.	\$0-\$5	\$0-\$5	\$0-\$5	\$0-\$5	\$0-\$5	\$0-\$5
D. Budget impact of limiting refunds to \$85 million per company per year (only shifts timing of refunds - impact is after all other provisions of bill)	Limited impact under forecast - net neutral between FY18-19-20					
E. The GVR cannot be used to create or increase a net operating loss (provision 5 above)	\$0	\$10-\$20	\$20-\$30	\$15-\$25	\$5-\$15	\$0-\$10
F. Budget impact of exploration credit extension for well spudded by 7/1/16	(\$5)-\$0	(\$5)-\$0	\$0	\$0	\$0	\$0
G. Budget impact of GVR applying to fields for a period of 5 years (provision 6 above)	\$0	\$0	\$0	\$0	\$0	\$0
Total Budget Impact	\$0-\$15	\$40-\$75	\$60-\$95	\$55-\$90	\$90-\$140	\$85-\$135
Total Fiscal Impact - does not include revenue impacts from potential changes in investment²	(\$5) - \$15	\$75	\$55-\$95	\$50-\$90	\$85-\$150	\$70-\$175
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	\$605	\$718	\$677	\$508	\$242	\$128
Change in year-end balance due to bill	-\$13	-\$33	-\$55	-\$77	-\$23	-\$8

¹The 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.

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

³These 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.