

SENATE FINANCE COMMITTEE

April 14, 2016

1:53 p.m.

1:53:52 PM

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 1:53 p.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Representative Dan Saddler, Sponsor; Kim Skipper, Staff,
Representative Dan Saddler; Juli Lucky, Staff,
Representative Mike Hawker; Janak Mayer, Chairman and Chief
Technologist, enalytica; Nikos Tsafos, President and Chief
Analyst, enalytica;

SUMMARY

SB 130 TAX;CREDITS;INTEREST;REFUNDS;O & G

SB 130 was HEARD and HELD in committee for further consideration.

CSHB 188(FIN)

PERSON W/DISABILITY SAVINGS ACCOUNTS

CSHB 188(FIN) was REPORTED out of committee with "no recommendation" and with one previously published zero fiscal note: FN1 (DHS); and one previously published fiscal note: FN3 (REV).

CSHB 222(FIN)

INCREASE OF APPROPRIATION ITEM

CSHB 222(FIN) was REPORTED out of committee with "no recommendation" and with one previously published zero fiscal note: FN 1(LEG).

HB 247 TAX;CREDITS;INTEREST;REFUNDS;O & G

HB 247 was SCHEDULED but not HEARD.

#hb188

CS FOR HOUSE BILL NO. 188(FIN)

"An Act establishing a program for financial accounts for individuals with disabilities; exempting the procurement of contracts for the program from the State Procurement Code; exempting certain information on participants in the program from being subject to inspection as a public record; providing that an account under the program for an individual with a disability is not a security; allowing a state to file a claim against an individual's financial account under the program to recover Medicaid payments after the individual's death; and providing for an effective date."

[1:55:21 PM](#)

REPRESENTATIVE DAN SADDLER, SPONSOR, stated that the bill had received broad support from lawmakers and the Alaska Mental Health Trust. He believed that the bill would allow people who were disabled, and their families, to draw on their own funds for helping with the difficulties of living with a disability. He noted that the bill would be of no cost to the state.

[1:55:57 PM](#)

Senator Olson asked who would take over the account when the beneficiary passed away.

Representative Saddler replied that that funds would first go to attorneys that were handling the estate.

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KIM SKIPPER, STAFF, REPRESENTATIVE DAN SADDLER, interjected that the account would be distributed in the following order: administrative estate costs, funeral expenses, child support, and Medicaid claw back.

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Senator Olson asked why survivors of the deceased were not included on the list.

Representative Saddler clarified that the estate would be the last in line; if there was a will, or probate, it would go to the survivors as directed.

[1:57:48 PM](#)

Vice-Chair Micciche discussed FN 3.

[1:58:33 PM](#)

AT EASE

[1:58:51 PM](#)

RECONVENED

[1:58:55 PM](#)

Vice-Chair Micciche looked at FN 2.

[1:59:21 PM](#)

Co-Chair MacKinnon noted that FN 2 was in response to the need to change regulations in the following 12 months.

[1:59:40 PM](#)

Vice-Chair Micciche MOVED to report CSHB 188(FIN) out of Committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSHB 188(FIN) was REPORTED out of committee with "no recommendation" and with one previously published zero fiscal note: FN1 (DHS); and one previously published fiscal note: FN3 (REV).

[2:00:04 PM](#)

AT EASE

2:02:20 PM

RECONVENED

#hb222

CS FOR HOUSE BILL NO. 222(FIN)

"An Act relating to increases of appropriation items."

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Vice-Chair Micciche discussed FN 2. The note had zero fiscal impact.

2:03:13 PM

JULI LUCKY, STAFF, REPRESENTATIVE MIKE HAWKER, reminded the committee that the intent of the bill was to fully protect the legislature's power of appropriation by establishing a process to allow the legislature to limit the use of the RPL process.

2:03:48 PM

Vice-Chair Micciche MOVED to report CSHB 222(FIN) out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CSHB 222(FIN) was REPORTED out of committee with "no recommendation" and with one previously published zero fiscal note: FN 1(LEG).

2:04:16 PM

AT EASE

2:07:43 PM

RECONVENED

#sb130

SENATE BILL NO. 130

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage

facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

[2:08:01 PM](#)

JANAK MAYER, CHAIRMAN AND CHIEF TECHNOLOGIST, ENALYTICA, announced some of his background.

[2:09:09 PM](#)

Janak Mayer discussed the presentation, "CS SB 130: Key Issues and Assessment" (copy on file).

[2:09:15 PM](#)

Mr. Mayer looked at Slide 2, "Agenda":

CS SB 130: Summary of Key Issues

North Slope: Fiscal Regime Overview

North Slope: Changes Proposed

Cook Inlet: key issues and Proposed Changes

CS SB 130: Summary of Key Issues

Appendix

[2:10:09 PM](#)

Janak Mayer addressed Slide 3, "Summary: Common Proposed Changes":

Issue: Gross value reduction and net operating loss credit

Status Quo: Because GVR artificially reduces Production Tax Value, 35% NOL credit can be claimed on amount greater than actual loss - more than 35% support for spending.

CS HB 247 (FIN) / CS SB 130 (RES): Assess NOL credit on actual loss (not including GVR), so NOL is for 35% of actual loss, and all producers have 35% support for spending.

Impact: Make North Slope state support for spending uniform at 35%. Interaction is arguably an unintended consequence under SB21, though fixing has negative impact for current GVR new developments.

Issue: Time limit on gross value reduction

Status Quo: No current time limit on how long new developments benefit from GVR.

CS HB 247 (FIN) / CS SB 130 (RES): Allow GVR benefit only for 5 years from first production (or until 1/1/2021).

Impact: Short limit effectively eliminates much of the GVR benefit. Major negative impact on recently sanctioned eligible developments.

Issue: Refundable credit withholding

Status Quo: Liabilities against production tax withheld from refundable credits, but not other liabilities.

CS HB 247 (FIN) / CS SB 130 (RES): Any exploration/development/ production related liabilities to the state can be withheld from refundable credit payments.

Impact: Companies in dispute over liabilities will have those amounts withheld. Companies that wish to have withholding used to settle liability may do so.

Issue: .025 'Middle Earth' exploration credit

Status Quo: \$25 mm or 80% credit, sunsets July 1 2016.

CS HB 247 (FIN) / CS SB 130 (RES): Extend to allow for completion of wells spudded before July 1.

Issue: Municipal production expense deduction

Status Quo: Munis that own production and only sell portion can deduct all expenses and claim credits.

CS HB 247 (FIN) / CS SB 130 (RES): Credits and deductions can only be claimed in proportion to taxable production.

Issue: Surety bond

Status Quo: No bond requirement.

CS HB 247 (FIN) / CS SB 130 (RES): Add \$250,000 bond as license requirement.

[2:16:34 PM](#)

Mr. Mayer addressed Slide 4, "Summary: Divergent Proposed Changes":

Issue: Cook Inlet Tax credits & fiscal system

Status Quo: 25% Net Operating Loss credit, 20% Qualified Capital Expenditure credit, 40% Well Lease Expenditure credit; up to 65% gov't support for spending and minimal production tax

CS HB 247 (FIN): Reduce NOL credit to 10%, QCE to 10%, WLE to 20% by 2018. Restrict eligibility for NOL. Working group on Cook Inlet regime.

CS SB 130 (RES): Reduce NOL credit to 15%, QCE to 10%, WLE to 20% by 2017. No Credits and no production tax from 2018 Onward.

Impact: Cook Inlet credit regime is clearly unsustainable in current environment; degree of rampdown / elimination has fiscal-note impact, but also potential impacts on future investment.

Issue: North Slope gross minimum tax

Status Quo: 4% rate, binding for legacy output if net value is positive. If net value is negative, NOL can 'pierce' floor. "New," GVR-eligible production can take to zero due to \$5/bbl and small producer credit.

CS HB 247 (FIN): Introduce additional, 'harder' 2% gross floor; no credits can reduce tax liability below this.

CS SB 130 (RES): Maintain status quo - no further floor hardening.

Impact: Hardening has high fiscal-note impact, but most is revenue brought forward from future (NOL), not truly additional. Makes regressive system more so, and adds strain to cashflow-negative companies.

Issue: Refundable credit cap

Status Quo: Producers with >50 mb/d production must carry NOL forward, others can be reimbursed by the state. Major new NS development could place significant strain on state cashflow.

CS HB 247 (FIN): \$100mm per company annual limit on reimbursement.

CS SB 130 (RES): \$85mm per company annual limit on reimbursement.

Impact: Low limit substantially increases capital needs for new developments & raises hurdle rates/break-even prices. \$100mm likely not binding on companies now given current spending plans; \$85mm may have negative impact on some.

[2:24:05 PM](#)

Mr. Mayer highlighted Slide 5, "Summary: Divergent Proposed Changes":

Feature: 'Middle Earth' credits

Status Quo: 25% Net Operating Loss credit, 20% Qualified Capital Expenditure credit, 40% Well Lease Expenditure credit.

CS HB 247 (FIN): Maintain NOL at 25%, reduce QCE to 10%, WLE to 30% by 2018. WLE may sunset in 2019?

CS SB 130 (RES): Reduce NOL credit to 15%, QCE to 10%, WLE to 20% by 2017.

Impact: Fiscal impact of 'Middle Earth' credits currently minimal, but questions about capital credits may arise if significant development occurs.

Feature: Interest due on 'delinquent' taxes

Status Quo: Fed Discount Rate + 3% Simple Interest on delinquent taxes (up to 6-year audit statute of limitations).

CS HB 247 (FIN): Fed + 5% compounded quarterly for 3 yrs, then Fed + 5% simple interest (up to 6-year audit statute of limitations)

CS SB 130 (RES): Fed + 7% compounded quarterly for 3 yrs, then no interest (up to 6-year audit statute of limitations)

Impact: Current simple interest arguably a drafting oversight from SB21 debate. Core issues here determine 'fair' rate vs companies' concerns over impact of long audit backlog on interest bills when interest rate is higher and compounded.

Feature: Alaska hire

Status Quo: Alaska hire not currently given preferential treatment in tax code (significant constitutional restrictions).

CS HB 247 (FIN): No change

CS SB 130 (RES): No preferential treatment in amount of refunded credits, but companies with >75% Alaska hire placed higher in queue for refundable credit payments.

[2:28:18 PM](#)

Co-Chair MacKinnon noted that the house and senate versions of the bill differed considerably.

[2:28:40 PM](#)

NIKOS TSAFOS, PRESIDENT AND CHIEF ANALYST, ENALYTICA (vis teleconference), introduced himself.

[2:29:13 PM](#)

Mr. Mayer discussed Slide 6, "Summary: Visualizing Credits." He said that what both the house and the senate version of the bill hoped to address was the impact of Alaska's oil and gas tax credits at the current low prices. He stated that the slide represented the amount of credits, and where the credits were spent. He noted that the first bar on the slide split the credits in to North Slope and non-North Slope spending. The second bar split the refunded and non-refunded credits for the North Slope and non-North Slope operations. He noted that the majority of credits paid out in Cook Inlet were refunded credits. The third bar broke down the credits involved: North Slope dollar per barrel credit (introduced under SB 21), North Slope Operating Loss, North Slope other, and non-North Slope state support. He noted that the "other" credits bar would shrink going into the future, most of those credits no longer exist. He said that the only remaining credit of substance on the North Slope, other than the dollar per barrel credit, was the net operating loss credit. He relayed that expenses were deducted against revenues in any net profit system, and in the years that there was not enough revenue and companies experienced a loss, there was a means for costs to somehow be deducted.

[2:34:23 PM](#)

Co-Chair MacKinnon queried the difference of revenue generated as a result of the credits, versus merely the expense. She queried a slide that would relate the credits to the generated revenue.

Mr. Mayer stated that there would be a slide later in the presentation that would address the question. He said that operating loss credits would have to be paid; the question was whether they should be paid now or later as a deduction through the tax system.

[2:36:20 PM](#)

Vice-Chair Micciche asked where the well lease expenditure (WLE) and QCEs were captured for the North Slope.

Mr. Mayer replied that the only remaining credit on the North Slope was the net operating loss credit. He furthered that there used to be a capital credit, but there was never

a WLE. He said that the capital credit had been repealed under Alaska's Clear and Equitable Share (ACES). He noted that the green section of the third bar on Slide 6 reflected the non-North Slope state support. He stated that there were three big categories of credits at play: credits that were a mathematical exercise in determining the North Slope tax rate, credits on the North Slope that were about net operating losses that would be eventually recognized, and the Cook Inlet credits.

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Vice-Chair Micciche noted the \$595 million for the per barrel credit. He asserted that the figure shaped the overall underlying tax structure.

Mr. Mayer agreed.

[2:38:26 PM](#)

Co-Chair MacKinnon explained that the tax credit system was illustrated in three different ways on the chart. She stressed that the numbers did not reflect additional tax credits, but broke them down in different ways for the purpose of highlighting the value and usage of each credit.

Mr. Mayer agreed.

[2:38:57 PM](#)

Vice-Chair Micciche asked whether per barrel credits could be taken below the minimum, and if so, how they would be incorporated into the refunded credits.

Mr. Mayer replied that they would appear as non-refunded because they were taken by taxpayers against liabilities.

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Vice-Chair Micciche understood that it would be part of the \$655, in orange, on the second bar.

Mr. Mayer agreed. He reminded the committee that the numbers used on Slide 6 were from FY 15.

[2:40:59 PM](#)

Mr. Mayer highlighted Slide 7, Summary: History of Credit Payouts":

Refunded Credits Reached New High in FY 2015

Refundable credits in FY 2015 reached \$628 mm, the highest point ever

In both 2014 and 2015, the majority of these credits went to non-North Slope producers

Under DOR's current forecast, credits will exceed \$1.3 billion across FY 2016 and FY 2017

Mr. Mayer pointed out to the committee that in FY 15 the credits had reached an all-time high of \$628 million, and were projected to be higher in FY 17. He noted that there had not been an increase on the North Slope, the increase had been in non-North Slope credits.

[2:41:44 PM](#)

Vice-Chair Micciche understood that the following slide would address revenue. He thought a slide showing the elimination of non-North Slope credits, and the application of the production taxes, would be informative. He said that the public had a hard time understanding the value of the credits as they related in production and revenue to the state. He wanted a slide that would provide that information. He said that the state got value from Cook Inlet credits, but very little revenue to the state.

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Senator Dunleavy remarked that facts could sometimes ruin a good story. He asserted that SB 21 had not affected Cook Inlet.

[2:44:26 PM](#)

Vice-Chair Micciche added that SB 21 was working better for the state than ACES.

[2:45:02 PM](#)

Senator Bishop commented that looking at the numbers, it was clear that SB 21 had spurred production.

[2:45:50 PM](#)

Senator Dunleavy thought that the presenter could discuss the effects of more production on tariffs. He thought that tariffs could create lower or higher costs for shipping oil, which he believed was a North Slope issue. He asserted that the administration had admitted that the state would not be making more money under ACES.

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Co-Chair MacKinnon stressed that no one was currently making any money, given the current oil prices, but that ACES fared worse than SB 21 at \$40/bbl.

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Mr. Mayer remarked that new production could reduce costs. He said that the more volumes of oil that were flowing through the pipe, the more barrels that could support the cost of the pipeline. He expounded on the benefits of tariffs. He noted that under ACES there was a 20 percent capital credit and a 25 percent net operating loss credit, which meant that new producers without tax liability could put them together and receive 45 percent support for spending. SB 21 offered a transition period where the 45 percent support was maintained, with the understanding that it would be brought down to 35 percent to match the nominal rate of tax under SB 21.

[2:50:58 PM](#)

Mr. Mayer addressed Slide 8, "Summary: North Slope vs. Cook Inlet Credits":

Big difference between North Slope and Cook Inlet

The majority of refundable credits go to Cook Inlet producers

Cook Inlet production, however, generates limited direct revenue for the state

Credits on the North Slope are more limited but also a far smaller fraction of total value generated

Mr. Mayer noted that the slide charted where revenues came from and where credit spending occurred. The stacked bar on the left reflected FY 2105 numbers for total revenues through the oil and gas fiscal system and total spending on credits. He stated that below the zero baseline, in the light grey bars, was refunded tax credits, and above the baseline in dark grey was production tax, purple was corporate income tax, green was property tax, yellow and orange were both royalty - restricted and unrestricted. He relayed that the slide reflected over \$2.3 billion in revenues to the state in FY 15, with substantial credit expenditures of \$628 million. He related that nearly all of the revenue came from the North Slope; \$2.2 billion between restricted and unrestricted revenue, and \$224 million in outlay on reimbursed, refunded capital credits. He said that looking at only that picture, the question of refunded credit did not seem out of proportion to the revenue that was being brought in, if that was reinvestment in future production. He countered that the picture differed when looking at the Cook Inlet side of the equation, illustrated in the third bar on the slide.

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Senator Dunleavy noted that some of the outcomes in Cook Inlet could be due to additional incentives for gas that had been used in the area.

Mr. Mayer agreed that the Cook Inlet credits had been established during a time when there had been a great deal of concern over the future of the gas supply in Southcentral Alaska, and also during a time of higher oil prices. He believed that the time had come to revisit the equation using current variables.

[2:55:07 PM](#)

Vice-Chair Micciche turned to Slide 7. He asserted that the Cook Inlet credits were an exposure for the state. He requested information about how a sovereign would quantify the return to the state of the credit investment in Cook Inlet. He suggested that the state may have overinvested in Cook Inlet credits. He wondered how the investment could be defended, and understood that the conversation would take longer than the current meeting would allow.

Mr. Mayer replied that there were various ways to conduct the cost/benefit analysis. He suggested looking at royalty revenues that were received from current and future production, and at how that would compare overtime to the credits involved.

Mr. Mayer announced that the next section of slides would discuss an overview of the North Slope fiscal regime.

[2:58:59 PM](#)

Co-Chair MacKinnon announced that the meeting needed to end in 15 minutes. She noted that the committee could reconvene later in the day to finish the presentation.

[2:59:35 PM](#)

Mr. Mayer discussed Slide 10, "NS Overview: Gross vs. Net Taxes":

Hard to be both Norway & N. Dakota at Same Time

Gross taxes

Less volatile, shift risk to private sector

Simple and easy to administer

High/low government take at low/high prices

Disadvantages marginal investment

Net taxes

More volatile revenues for government

Harder to administer

Efficient—do not distort decision-making

Enable investment across commodity cycle

Mr. Mayer noted that the chart on the bottom right illustrated effective tax rates. He said that the idea of an effective tax rate was inherently a net tax concept; of the available profit generated in a given system, how much was taken in the form of tax. He stated that the numbers on

the graph compared a 25 percent net tax and a 10 percent gross tax. He relayed that the green line represented the net tax and stayed at 25 percent all the way across the chart from \$40/bbl to \$150/bbl. He shared that the gross tax was highly regressive; when prices were lowest the tax was high, and got lower at high prices. He ran through the numbers in the lower left of the slide. He explained that at \$80/bbl the production tax value of each barrel was \$34/bbl. He discussed the gross versus net taxes \$80/bbl. He said that as prices dropped the gross taxes took up more and more of the profit available. He related that gross taxes were less volatile and shifted the risk to the private sector. He furthered that administering a net tax was more difficult because incurred costs needed to be determined, which contributed to audit backlogs. He said that the state had made the decision for over a decade to have a net profit tax system, which required planning for volatility of revenue and maintaining substantial savings and assets, while relying more on earnings from the assets than the direct revenue from the oil and gas tax system to run the state. He added that a more diversified economy would also be beneficial to the state.

[3:07:33 PM](#)

Mr. Mayer looked at Slide 11, "NS Overview: Cash Flow Taxes":

Cashflow taxes: More efficient, more volatile

Purpose of net tax is to minimize distorting impact on investment

Best achieved by making the state's fiscal cost/benefit as close as possible to equity investor

Results in outflows during development, receipts during production

He spoke to the highly simplified cashflow and income example presented on the slide. He stressed the importance of distinguishing between cashflow and net income. He spoke to the numbers reflected on the slide related to the hypothetical development of a small oil field.

[3:12:56 PM](#)

Co-Chair MacKinnon announced that a continuation of the presentation would be scheduled for the following day. She noted that the committee would be back at 5pm to hear a different presentation.

#hb247

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

HB 247 was SCHEDULED but not HEARD.

#

ADJOURNMENT

3:14:00 PM

The meeting was adjourned at 3:13 p.m.