

SENATE FINANCE COMMITTEE

May 14, 2016

2:05 p.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 2:05 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

Randall Hoffbeck, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Alexei Painter, Analyst, Legislative Finance Division; Senator Cathy Giessel; Representative Tammie Wilson; Representative Sam Kito.

SUMMARY

2d CSHB 247(RLS)am

TAX;CREDITS;INTEREST;REFUNDS;O & G

2d CSHB 247(RLS)am was HEARD and HELD in committee for further consideration.

#hb247

2d CS FOR HOUSE BILL NO. 247(RLS) am

"An Act amending the powers of the board of trustees of the Alaska Retirement Management Board to authorize purchase and sale of transferable tax credit

certificates issued in conjunction with the production tax on oil and gas; relating to interest applicable to delinquent tax; relating to the oil and gas production tax, tax payments, and credits; relating to exploration incentive credits; 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 confidential information status and public record status of information in the possession of the Department of Revenue; relating to oil and gas lease expenditures and production tax credits for municipal entities; requiring a bond or cash deposit with a business license application for an oil or gas business; establishing a legislative working group to study the fiscal regime and tax structure and rates for oil and gas produced south of 68 degrees North latitude; and providing for an effective date."

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, remarked that he had briefed the governor on the components of the current version of the legislation. He stated that the governor supported the bill.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, introduced himself. He stated that the current version was C.A. He shared that his format addressed the basic provisions of the bill, but the bill was different than they day before. He stated that the version was based on what came out of the House Finance Committee substitute.

Mr. Alper discussed the presentation, "Oil and Gas Tax Credit Reform CS HB247(RLS)\C amended H; Department of Revenue; Overview of House-passed CS for Senate Finance; May 14, 2016" (copy on file).

Mr. Alper looked at slide 2, "Introduction":

Thank you for welcoming us back

- This bill is substantially changed from what we presented yesterday

- The major amendment which rewrote much of the bill, from Reps. Seaton and Wilson, was largely based on the House Finance CS

- We're using the same format as yesterday. Changes from the House Rules version, as we described it in our prior presentation, are indicated with purple italics

Major new items are also indicated with a different form of bullet

Mr. Alper highlighted slide 3, "Major Provisions in House-Passed Bill":

1. Exploration Credits

- Governor's bill
 - Allows existing credits to sunset on 7/1/16
 - Keeps "middle earth" extension to 1/1/22
 - Repeals older dormant DNR exploration credits
- House bill
 - Also keeps the change made in several earlier versions to extend the "Frontier Basin" credit to protect ongoing AHTNA investment
 - Extends this language one year due to additional delay in acquiring a rig

Mr. Alper addressed slide 4, "Major Provisions in House-Passed Bill":

2. Cook Inlet (and Middle Earth) Credits

- Governor's bill
 - Eliminated 20 percent QCE and 40 percent WLE, kept 25 percent NOL
 - Kept 2022 "tax cap" sunset
- House bill

- NOL kept at 25 percent in 2017 but only if producing by end of 2016. To 0 percent in 2018
- QCE repealed 1/1/17
- WLE reduced to 20 percent for 2017 and repealed in 2018

Moves up 2022 tax cap sunset to 2019. This imposes the high underlying tax in 2019 with expectation of new system as proposed by "working group"

- Maintains Middle Earth 25 percent NOL if under a plan of development, along with 10 percent QCE

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Mr. Alper looked at slide 5, "Major Provisions in House-Passed Bill":

3. North Slope Credits, Limits, Carry-Forwards

- Governor's bill
 - Kept 35 percent NOL rate (not current administration policy)
 - Capped repurchase at \$25 million / company / year, large company exclusion, 10 year sunset

- House bill

No NOL credit or carry-forwards after 2016 for companies producing over 15,000 barrels / day

- Smaller producers still eligible for refunded NOLs with cap of \$70 million / company / year. Must be from a lease from which the state receives a royalty, under a plan of development, and in which the producer has a working interest

NOL rate ramps down: 32 percent in 2017; 29 percent in 2019; 26 percent in 2021; 25 percent in 2023

Mr. Alper remarked that slide 5 reflected the most major changes to the legislation.

Mr. Alper addressed slide 6, "Major Provisions in House-Passed Bill":

4. Minimum Tax Changes

- Governor's bill
 - Increased "floor" to 5 percent
 - "Hardened" minimum tax against NOLs, \$5 per-barrel credit for new (GVR) oil, small producer, and exploration credits

- House bill

Adds a 5 percent "floor" but only if yearly price is over \$70 / bbl. Doesn't harden against additional credits

- Because NOLs are no longer carried forward by large producers, floor indirectly hardened

- Revenue impact delayed to 2020 because pre effective date NOLs can still be used to go below floor

Co-Chair MacKinnon queried an example of a high-low scenario of what "pierces" the floor. Mr. Alper agreed to provide that information.

Co-Chair MacKinnon requested that the information be as clear as possible.

Senator Bishop queried the number of producers below 15,000 and the number of producers above 15,000. Mr. Alper agreed to provide that information.

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Mr. Alper highlighted slide 7, "Major Provisions in House-Passed Bill":

5. New Oil "GVR" Provisions

- Governor's bill

- No changes
- House bill
 - 7-year "graduation" of GVR oil to become legacy oil

If the average price of oil exceeds \$70 for any three years, the GVR sunsets early, with the production reverting to legacy oil

Co-Chair MacKinnon requested a scenario that outlined Point Thompson's effect of the five dollar credit, and how it affected the floor. Mr. Alper replied that the five dollar a barrel credit for new oil could be used below the floor to go to zero under current law. He wondered if she wanted modeling related to how the bill would change Point Thompson's tax treatment in the future.

Co-Chair MacKinnon requested a detail of Point Thompson's tax structure under current state statute, and how the legislation would impact Point Thompson. Mr. Alper agreed to provide that information.

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Mr. Alper looked at slide 8, "Major Provisions in House-Passed Bill":

6. New Provisions

"Migrating Credits": (Provision from Governor's original bill.) Prevent per-barrel credits not usable in one month, due to minimum tax, from being applied in another month.

No impact unless substantial price volatility within a year

"ARM Board Alternative Purchase Option":
Authorizes Alaska Retirement Management Board to repurchase credits at 60 percent of face value. DOR mandated to repurchase these credits at full value, notwithstanding any per-company limits, within 5 years

Senator Hoffman queried the impact of the change require in additional audit time. Mr. Alper replied that the issue was only relevant in a year where there was months above and below the minimum tax. He stated that 2014 was the only year when that occurred. He asserted that there may be additional scrutiny, but it was not a retroactive provision. The bill was only relevant in a future year at a time of price volatility.

Vice-Chair Micciche wondered why the presentation did not include the gross value at the point of production. Mr. Alper replied that he neglected to include that change in the presentation.

Mr. Alper explained that the ARM Board Alternative had been empowered before Alaska's Clear and Equitable Share (ACES).

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Co-Chair MacKinnon stressed that the option may not have been vetted enough. She wondered whether the ARM Board had been consulted about repurchasing credits. Commissioner Hoffbeck replied that there was no ARM Board meeting at the time of bill inception. He shared that he had contacted Gary Vader, and he said that the investment was seen as a viable investment by the ARM Board.

Co-Chair MacKinnon wondered if there was a "gate" on how much the ARM Board could put out at a 60 percent buy back that required the state to pay 100 percent. Commissioner Hoffbeck replied that it must fall under the ARM Board's investment criteria.

Co-Chair MacKinnon asked whether the administration contemplated a possible draw from the general fund, if a large portion of tax credits purchased at 60 percent were demanded at one particular time. Commissioner Hoffbeck wondered if the reference was to the ARM Board investments.

Co-Chair MacKinnon remarked that \$770 million was available, with a limited access of DOR, she queried the liability in one year should the ARM Board attempt to ask the state for 100 percent. Commissioner Hoffbeck replied that the ARM Board would consult with DOR, and DOR would examine the ability of the state to repay.

Mr. Alper furthered that the ARM Board language was in two different places in the bill.

[2:31:03 PM](#)

Mr. Alper addressed slide 9, "Major Provisions in House-Passed Bill":

7. Misc. and Technical Provisions

a) Gov: GVR can't be used to increase the size of an NOL

House: Kept as written

b) Gov: Municipal Utility Lease Expenditure proration

House: Kept as written

c) Gov: Transparency, can release amount of credits received and the work done to earn them

House: Limited to refunded credits, and dollar total only

d) Gov: Interest Rate increase from 3 percent over Federal Reserve, simple to 7 percent over Fed, compounding

House: Increase to 5 percent over Fed, compounding, with simple interest after four years

Co-Chair MacKinnon queried clarity in the bill for when the department would implement the tax increases. She wondered whether the provision was retroactive or prospective. Mr. Alper replied that the interest rate was tied to the current time.

Co-Chair MacKinnon surmised that it was retroactive. Mr. Alper replied that it was only in the time period that the taxes were delinquent after January 1, 2017.

Co-Chair MacKinnon wondered if it would apply to a tax return submitted in 2012. Mr. Alper replied in the affirmative. The 2012 tax return would have different levels of interest, because the tax was delinquent. He stressed that the interest was based on the time, not on the origin of the tax return itself.

[2:34:53 PM](#)

Mr. Alper looked at slide 10, "Major Provisions in House-Passed Bill":

7. Misc and Technical Provisions (con't)

e) Gov: Alaska Hire tied to percentage of credit that can be refunded

House: Level of Alaska Hire as prioritization for repurchase given limited funds, including contractors

f) Gov: Credits can be used to offset other delinquent obligations to the state such as royalties

House: Credits can be held back if obligation is related to company's oil and gas business

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Senator Bishop surmised that the Alaska Hire was not tied to a percentage. He wondered how the credit was paid out. Mr. Alper remarked that the language was in Section 45(g)(2), which stated that "the department must grant a preference between two applicants to the applicant with the higher percentage of resident workers, and the applicant's workforce, including workers employed by the applicant's direct contractors in the state in the previous calendar year."

Senator Bishop surmised that the high percentage could be 51 percent. Mr. Alper replied in the affirmative.

Co-Chair MacKinnon queried the calculation of the contractors in higher corporations. She wondered if the calculation would be global. Mr. Alper replied that it was calculated based on work related to their Alaska operations.

Co-Chair MacKinnon wondered how that calculation applied to fishing. Mr. Alper stated that he did not understand the question.

Co-Chair MacKinnon wondered how to apply resident work status to fishing. Mr. Alper replied that he did not understand the question enough to provide a meaningful answer.

Co-Chair MacKinnon remarked that hundreds of workers were brought into work in the fishing industry. She wanted to

see how the Department of Labor and Workforce Development (DOL) quantified Alaska Hire for the fishing industry. Mr. Alper replied that DOL published an analysis by business sector in the state, by industry.

Co-Chair MacKinnon requested that DOL present how their numbers were quantified.

Senator Bishop asserted that the same guidelines for the Permanent Fund Dividend were used in determining the percentage of Alaska Hire. Mr. Alper agreed.

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Mr. Alper continued to discuss slide 10:

g) Gov: No bonding or other formal means to protect local vendors from bankruptcy
House: \$250k surety bond with local vendor priority

Mr. Alper discussed slide 11, "Summary of Fiscal Impact; Summary Analysis of Bill Versions (\$millions); (based on Spring 2016 Forecast)." He stated that the bill had a somewhat higher dollar value than the House Rules committee substitute version.

Co-Chair MacKinnon queried the effects of the bill on production. Mr. Alper wondered if it should be a forecast in possible changes to production.

Co-Chair MacKinnon wanted to know the impact of production by the bill. Mr. Alper replied that he did not believe that the forecast could be done by Monday.

Co-Chair MacKinnon expected that there would be numbers specific to the bill to provide that information to Alaskans.

Co-Chair Kelly wondered whether there was an ability to provide an impact on production. Mr. Alper replied that the production forecast was developed from information from the producers.

Co-Chair Kelly asked whether the information from producers could be obtained. Mr. Alper agreed to provide that information.

Co-Chair MacKinnon wondered if job loss could be quantified based on the current scenario.

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Senator Bishop asked for a restatement of the question related to job loss.

Co-Chair MacKinnon wondered if there was a place within DOL that would quantify any job loss resulting from the legislation. Senator Bishop replied that there was the opportunity for good data on job loss in the state.

Vice-Chair Micciche noted that the industry had recently made significant reductions in price. He stressed that the industry had experienced significant reductions in project work. He felt that asking the industry to incorporate the impacts would take months to accurately quantify. He wondered whether the bill would result in greater or less production; whether it would result in additional jobs or less jobs; and what other levers should be evaluated as a state in the general effect of the bill. Mr. Alper replied that any transfer of wealth between the sovereign and the lessee would change decision making. He stressed that there was an examination of whether the marginal benefit was better than the marginal cost.

Senator Bishop wondered whether it was positive or negative. Mr. Alper replied that less money and less certainty would probably be negative.

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Vice-Chair Micciche surmised that there would be some job loss, and some negative production effect. He queried the philosophy of the administration on the balance. He queried the larger effect of the bill, and wanted to know how to minimize the effect on everyone in the state. Commissioner Hoffbeck shared that all of the actions to close the budget

gap would have large impacts to money in the system. He remarked that there would be job cuts in many industries.

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Co-Chair Kelly stressed that the change in the credit system impacted the system. He felt that the bill would reduce production. He remarked that the state should not reduce oil production. He expressed concern that the administration would propose changes, without fully understand the impact on production.

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Senator Bishop looked at the FY 17 NOL on the final slide of the presentation. He noted that \$200 million was included from the previous year's veto. Mr. Alper responded that the carry forward were the companies that were not able to receive credit cash because they were the large producers. The category was new in the Spring Forecast.

Commissioner Hoffbeck furthered that it was in addition to the cash flow credits.

Mr. Alper stated that the forecasted price of oil would result in the majors being in possession of \$618 million in un-cashable NOLs. The governor's bill would increase that number to \$773 million. The hardening of the floor required a full minimum tax payment, instead of carried forward NOLs.

Senator Bishop remarked that the number could change with additional changes to the market. Mr. Alper agreed.

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AT EASE

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RECONVENED

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Co-Chair MacKinnon shared that the public testimony would take place the following day.

Vice-Chair Micciche remarked that there had been discussions related to the differences in assumptions for

earnings. He requested that information. Mr. Alper shared that the document had been delivered.

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AT EASE

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RECONVENED

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Co-Chair MacKinnon shared that the document was being distributed to the committee.

Senator Olson queried the impact to the fiscal gap looking at the changes in the state's financial liability. Commissioner Hoffbeck replied that there would be reductions in production based on \$40 a barrel oil. He remarked that there needed to be a balance of the incremental productions and the needs of Alaska.

Senator Olson surmised that the bill was attempting to address the fiscal situation, which had more gravity than the loss of production. Commissioner Hoffbeck replied in the affirmative.

Co-Chair MacKinnon shared that the governor had provided a suite of options to address the budget shortfall, including an income tax. She wanted to understand the impact of affecting production.

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ALEXEI PAINTER, ANALYST, LEGISLATIVE FINANCE DIVISION, commented that in the three committees there was a fund capitalization fiscal note that had been prepared, but not adopted. He remarked that the bill did not address with how to pay the credit. He stated that, currently in the operating budget, there was a statutory calculation of the payment. The language indicated was \$73.4 million, which was the estimate under the Fall Forecast. He stated that the Spring Forecast showed it closer to \$30 million. He asserted that, without additional capitalization of the oil and gas tax credit fund, only \$30 million would be available in FY 17 to pay those credits.

Co-Chair MacKinnon wondered if there had been a review of the interest rate percentage, and any related financial tabulations. Mr. Painter responded that he had not studied it in depth.

Co-Chair MacKinnon queried comment on the NOLs as amended. Mr. Painter replied that he did not have any comment on the substance of the bill.

2d CSHB 247(RLS)am was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

3:26:25 PM

The meeting was adjourned at 3:26 p.m.