

SENATE FINANCE COMMITTEE

May 5, 2017

9:07 a.m.

[9:07:38 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:07 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Shelley Hughes
Senator Peter Micciche

MEMBERS ABSENT

Senator Lyman Hoffman, Co-Chair
Senator Click Bishop, Vice-Chair
Senator Donny Olson
Senator Natasha von Imhof

ALSO PRESENT

Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Senator Cathy Giessel; Senator Gary Stevens; Representative Geran Tarr; Representative Chris Birch.

SUMMARY

CSHB 111(FIN)(efd fld)

OIL and GAS PRODUCTION TAX;PAYMENTS;CREDITS

CSHB 111(FIN)(efd fld) was HEARD and HELD in committee for further consideration.

#hb111

CS FOR HOUSE BILL NO. 111(FIN)(efd fld)

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax;

relating to carried-forward lease expenditures based on losses and limiting those lease expenditures to an amount equal to the gross value at the point of production of oil and gas produced from the lease or property where the lease expenditure was incurred; relating to information concerning tax credits, lease expenditures, and oil and gas taxes; relating to the disclosure of that information to the public; relating to an adjustment in the gross value at the point of production; and relating to a legislative working group."

[9:08:54 AM](#)

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, introduced himself.

[9:09:28 AM](#)

AT EASE

[9:10:20 AM](#)

RECONVENED

Co-Chair MacKinnon announced that the presentation would be a continuation of the presentation from the prior day.

[9:10:50 AM](#)

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, highlighted slide 21, "Fiscal Analysis" of the presentation titled, "DOR Senate Finance Presentation" (copy on file):

Fiscal Note Summary- Tax

- Senate bill makes no material changes to SB21 provisions
- Loosening of existing minimum tax protection against small producer and GVR credits results in ~\$20-40 million less revenue per year through FY24
- Senate Resources bill provides certain limited "hardening" of the minimum tax floor to NOLs, since these are no longer "credits."
 - o Provision has no fiscal impact at forecast prices
 - o Modeling indicates a tax increase in the alternative price scenarios at \$40 oil when major producers would be expected to have operating losses

9:14:05 AM

Co-Chair MacKinnon wondered whether the most recent version of the bill would "pierce" the minimum credit, or was it existing for small producers. Mr. Alper replied that the small producer credit could not be used to go below the floor should the company used sliding scale per barrel credits under current law. He relayed that the bill stated that the small producer credit, and the five-dollar per barrel credit, could be used below the floor.

Co-Chair MacKinnon wondered whether the idea contributed to the confusion about the comparison with the house bill and the advisory bulletin. She remarked that tax payers had previously ordered credits differently than the advisory bulletin. She stressed that she was referencing the most recent version of the bill, versus the house version of the bill. She stated that the advisory report changed some of the language. Mr. Alper responded that the house bill did not have a similar provision.

Senator Hughes stressed that the structure affected the activity of the company. She noted the second bullet in the slide, and wondered whether there was a consideration of the policy change and how it might impact the activity of the company. Mr. Alper replied he did not make any assumptions about changes in behavior. The fiscal note tables were based on the assumptions for spending and production. He stated that any change in company behavior would result in a change in the numbers.

9:20:20 AM

Mr. Alper addressed slide 22, "Fiscal Analysis":

Fiscal Note Summary- Budget

- Additional impact due to near-total elimination of cash payments for tax credits (reduced spending)
 - o Long term forecast for cash credits is \$150 million / year; reduced to essentially zero
 - o Most of the associated projects don't come into production during the fiscal note period
 - \$1.325 billion in reimbursable credit obligation removed over the 10-year fiscal note period

- o Resulting "carried forward" balance, with uplift, is \$1.785 billion in 2027 that can offset future taxes
- o Of this, about \$460 million is accrued "uplift"

In response to a question from Co-Chair MacKinnon, Mr. Alper explained that the governor wanted the state to leave the business of buying cash credits.

Co-Chair MacKinnon wondered whether the administration believed that the funds were owed to the tax payer. Mr. Alper wondered whether the question was prospective or the held tax credit certificates.

Co-Chair MacKinnon stated that her question referred to reflective action. She remarked that the bill set up a system that required the state to owe money, and she hoped that the state's "word was good going forward" as it carried forward the losses. Mr. Alper agreed that they were an obligation to the state. He remarked that, if the credits were held until the company began production, it became a reduction from the paid tax.

Co-Chair MacKinnon surmised that there was no term limit. Mr. Alper replied that it depended on policy.

[9:25:32 AM](#)

Senator Micciche wondered whether there was an improvement from the prior system with the current or similar legislation. Mr. Alper replied that the strength of the "ring fence" provisions in the bill were important. He stated that it was possible that a bankrupt company could be bought by a major producer, and the carried forward losses would be purchased that could be used to offset taxes from another field. He stated that it was a concern over the current structure of the bill. He stated that the house bill had a stronger "ring fence", that said that the carry-forwards could only be used against the production from the associated fields at the point of original spending.

Senator Micciche wondered whether there was a greater benefit leading to a greater probability of production using the method, versus incentivizing spending as opposed to productive spending. Mr. Alper could not speak to the likelihood of what would lead to production. He shared that

the advantage of a cash credit based system would make it easier for new entrants to come into the world, but they may not be able to bring production.

Mr. Alper looked at slide 23, "Impact of Advisory Bulletin":

Many of the circumstances that show as a tax "decrease" are due to exceptions to the 3/31/17 advisory bulletin on ordering of credits

- For the most part, if the interpretation that many held prior to 3/31 was the actual legal status, this bill would be revenue neutral (no tax increase or decrease)
- Advisory bulletin tends to "push" certain cashable credits into future years, as companies can't use them in the year incurred. In the absence of the bulletin, it's likely that the "budget impact" (change in cash credit demand) of SCS CSHB111(RES) would be slightly higher in the near term and lower in the later years

Co-Chair MacKinnon noted that there was some disconnect between the economists and the auditors. She remarked that the auditors were basing support of the advisory opinion on two minutes of conversation about an amendment. She wondered how a previous bill impacted the issue. She appreciated that the bill was net neutral. Mr. Alper replied that the advisory bulletin was not informed by two minutes of testimony at 1:30am on April 4, 2013. He stated that the drafting of the regulation was informed by that conversation. The regulation was written to interpret the perceived intent of the maker of that amendment. He stressed that the regulatory process was extensive and controlled with drafts, public review, legal review, and publication. He stressed that the language was the same throughout the process without comment. He stated that the advisory bulletin clarified what was already in regulation.

Co-Chair MacKinnon felt that from the legislature's perspective, Department of Revenue (DOR) may have had the wrong interpretation of the regulation. She queried the statute that provided that authority. She assumed that there was a bill that allowed tax payers to decide how to use their credits to advantage their tax position to increase production. Mr. Alper replied that he gave incorrect information to the committee. He stated that he was not a career tax administrator, and those in DOR

corrected the record. The statutory direction was in AS 43.55.024(j), which was the sliding scale credit. The statute said that the credit could not be used to reduce taxes below the minimum tax. He stated that the previous regulations from the beginning of credits talked about the ability of companies to order their credits in the sequence to their own best advantage. He stated the addition in 2013 was new language that bundling meant you cannot go below the floor.

Co-Chair MacKinnon felt that the tax payer would address the interpretation. Mr. Alper stated that there were many that knew the statutes better than him.

[9:36:24 AM](#)

Mr. Alper highlighted slide 24, "Fiscal Analysis-impact of forecast prices." He stated that the table outlined the fiscal note. He remarked that the light blue colors were subtotal lines. He stated that all the lines above the blue lines were changes in taxes based on various provisions of the bill.

Co-Chair MacKinnon looked at "Total Revenue Impact." She stated that the negative number represented a loss of revenue to the state. She remarked that the advisory bulletin indicated that loss. Mr. Alper stated that the largest component of the negative numbers was on line 3, and he would address lines 1 and 2.

Co-Chair MacKinnon stressed that negative numbers were normally a "good thing." She noted that the negative number was indicative of the state receiving less. Mr. Alper agreed.

Co-Chair MacKinnon wondered whether the issue was standard in the oil and gas industry. Mr. Alper replied in the affirmative.

[9:41:40 AM](#)

Mr. Alper continued to discuss slide 24. He stated that line 2 was the ability added by the legislation of certain tax payers being allowed to offset their cash credits with corporate income tax. He noted that the number was approximately \$5 million to \$10 million of lower revenue. He stressed that the number was not related to the advisory

bulletin, but would be considered reduced corporate income tax revenue. He stated that line 3 opened up the ability to use certain credits below the floor, specifically the five dollar per barrel credit and the small producer credit. He stated that the small producer credit was in the process of a long sunset, and the numbers were not material after three or four years.

Co-Chair MacKinnon surmised that line 3 represented the impact of the advisory bulletin. Mr. Alper agreed

Mr. Alper continued to discuss slide 24. He shared that the budget portion referred to appropriations. He stated that the biggest change was the elimination of North Slope operating loss credits.

[9:45:03 AM](#)

Co-Chair MacKinnon surmised that similar language could be used to describe the costs for leases that were applied to the production tax. Mr. Alper replied that there was a time difference in that analysis. He explained that a lease expenditure would see a shift in a number of years. He stated that the bill found a corporate income tax to offset in real time to be seen in the same fiscal year.

Mr. Alper finished discussing slide 24. He noted that the total impact was approximately \$150 million per year over the long-term. He stated that the total fiscal impact was the sum of the budget and fiscal impact. He stated that last component dealt with the value of the carry-forward lease expenditures, which were aggregate numbers that changed over time.

Senator Micciche asked about the total shift in total state spending associated with the bill. Mr. Alper shared that there was a forecast of approximately \$3.8 billion to be spent in the time period. He stated that, under current law, the \$3.8 billion would be spent by companies that were eligible for cash credits. He shared that the \$3.8 billion would turn into approximately \$1.3 billion of credits, that current law required the state to pay. He stated that the legislation allowed that money to accumulate to track company carry-forwards to be used against future taxes.

[9:50:42 AM](#)

Senator Micciche surmised that the total fiscal impact line was reflecting the uplift going forward. Mr. Alper replied that the total fiscal impact reflected that the state was no longer buying the credits and small tax changes. The impact of the carry forwards did not show up before 2027, because they were a future obligation.

Senator Micciche stressed that the discussion was related to only production taxes. Mr. Alper responded that there was no anticipated change in royalty within the fiscal note.

Senator Micciche felt that there was an attempt to not pay cash credit, with the hope that the credit would be paid by producing companies in the future. He remarked that removing the number in 2027 resulted in nearly the same number of tax credits paid in the future by the producing entity. Mr. Alper agreed.

Senator Micciche hoped to have further discussions about the North Slope infrastructure. He noted that there would be a subtraction of that outstanding yearend balance associated with additional royalty and property taxes. Mr. Alper replied that the state's obligation did not come to fruition until the oil production occurred resulting in taxes and royalties to the state.

Co-Chair MacKinnon restated that it was an "accurate statement." Mr. Alper agreed.

[9:55:13 AM](#)

Co-Chair MacKinnon noted that the plan was based on a decade of projections and assumptions by the Department of Natural Resources (DNR). Mr. Alper replied that one of the components of the underlying revenue estimate was the forecast of production from DNR.

Co-Chair MacKinnon surmised that the slide was ten years of forecasting for the price of oil. She remarked that there could be some dramatic changes based on price. Mr. Alper agreed, and stated that the following slide addressed that issue.

[9:56:36 AM](#)

Mr. Alper discussed slide 25, "Fiscal Analysis-Impact at Range of Prices." He stated that the chart showed the impact at different price points.

Senator Hughes looked at slide 24. She wondered how the advisory bulletin would have impacted the number in the bottom right corner. She remarked that there may be the same number without the change of policy, but remarked that there would be a change with inflation. Mr. Alper replied that he would provide that analysis. He noted that the credits that could go below the floor, referenced in line 3 were credits that were not generally cashable.

Mr. Alper continued to discuss slide 25.

[10:04:01 AM](#)

Co-Chair MacKinnon remarked that the state did not need to protect itself from additional losses, because there was current production. Mr. Alper stated that the oil prices were extremely low at the time of the previous discussion.

Co-Chair MacKinnon stressed that the government could not always predict how the private sector would respond, when they were in a negative position. Mr. Alper agreed.

Co-Chair MacKinnon stated that there was reason for optimism. Mr. Alper agreed.

[10:07:20 AM](#)

Mr. Alper highlighted slide 26, "Impact of Carried Forward Liability":

It is hard to capture the future impact of carried forward losses that don't have associated production during the fiscal note period

- The \$1.785 billion represents about \$3.8 billion in carried forward losses (\$1.325 billion at 35 percent) plus uplift
- None of these totals include the not-yet-committed spending that would be required for any of the large announced discoveries

Co-Chair MacKinnon wondered if the outline reflected worldwide behavior. Mr. Alper replied in the affirmative.

Mr. Alper addressed slide 27, "Fiscal Analysis":

Preliminary Life Cycle Analysis

- DOR's model looks at total state and producer cash flow over 40 years for a large North Slope new field development

- o 750 million barrels recovered, maximum production of 120,000 bbl/ day

- Senate Resources Bill reduces producer cash flow by

- o \$165 million and reduces IRR by 0.3 percent

- o Production tax is zero for three years (GVR) and minimum tax for seven years after due to use of carryforwards.

Full production tax begins in year 11

- o This assumes the interpretation that the use of carryforwards allows for the loss of per-barrel credits. If this were rewritten, the minimum tax would be in place due to more years of carry-forward use

[10:14:25 AM](#)

Co-Chair MacKinnon queried the amount of royalties the state would receive in the timeframe with the analysis. Mr. Alper replied that, presuming the statutory tax at a point of relatively high production layered with the royalties at forecasted prices, there would be nearly \$1 billion in state revenue from that large field.

Co-Chair MacKinnon noted that the number was mostly impacted by the advisory bulletin. Mr. Alper replied that the advisory bulletin was the presumptive status quo, so he did not know whether it had material impact.

CSHB 111(FIN)(efd fld) was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

[10:17:20 AM](#)

The meeting was adjourned at 10:17 a.m.