ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE
April 19, 2017
1:58 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator John Coghill, Vice Chair
Senator Natasha von Imhof
Senator Shelley Hughes
Senator Kevin Meyer
Senator Bill Wielechowski

MEMBERS ABSENT

Senator Bert Stedman

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE 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."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 111
SHORT TITLE: OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS
SPONSOR(s): RESOURCES

02/08/17	(H)	READ THE FIRST TIME - REFERRALS
02/08/17	(H)	RES, FIN
02/08/17	(H)	TALERICO OBJECTED TO INTRODUCTION

02/08/17	(H)	INTRODUCTION RULED IN ORDER
02/08/17	(H)	SUSTAINED RULING OF CHAIR Y23 N15 E2
02/08/17	(H)	RES AT 1:00 PM BARNES 124
02/08/17	(H)	Heard & Held
02/08/17	(H)	MINUTE(RES)
02/13/17	(H)	RES AT 1:00 PM BARNES 124
02/13/17	(H)	Heard & Held
02/13/17	(H)	MINUTE(RES)
02/17/17	(H)	RES AT 1:00 PM BARNES 124
02/17/17	(H)	Heard & Held
02/17/17	(H)	MINUTE(RES)
02/20/17	(H)	RES AT 1:00 PM BARNES 124
02/20/17	(H)	Heard & Held
02/20/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 1:00 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 6:30 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/24/17	(H)	RES AT 1:00 PM BARNES 124
02/24/17	(H)	Heard & Held
02/24/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 1:00 PM BARNES 124
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 7:00 PM CAPITOL 106
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
03/01/17	(H)	RES AT 1:00 PM BARNES 124
03/01/17	(H)	Heard & Held
03/01/17	(H)	MINUTE(RES)
03/01/17	(H)	RES AT 6:00 PM BARNES 124
03/01/17	(H)	Heard & Held
03/01/17	(H)	MINUTE(RES)
03/06/17	(H)	RES AT 1:00 PM BARNES 124
03/06/17	(H)	Scheduled but Not Heard
03/06/17	(H)	RES AT 6:30 PM BARNES 124
03/06/17	(H)	Heard & Held
03/06/17	(H)	MINUTE(RES)
03/08/17	(H)	RES AT 1:00 PM BARNES 124
03/08/17	(H)	Heard & Held
03/08/17	(H)	MINUTE(RES)
03/08/17	(H)	RES AT 6:00 PM BARNES 124
03/08/17	(H)	Heard & Held
03/08/17	(H)	MINUTE(RES)
03/09/17	(H)	RES AT 5:00 PM BARNES 124

03/09/17	(H)	-- MEETING CANCELED --
03/10/17	(H)	RES AT 1:00 PM BARNES 124
03/10/17	(H)	Heard & Held
03/10/17	(H)	MINUTE(RES)
03/11/17	(H)	RES AT 12:00 AM BARNES 124
03/11/17	(H)	-- MEETING CANCELED --
03/13/17	(H)	RES AT 1:00 PM BARNES 124
03/13/17	(H)	<Bill Held Over from 3/11/17>
03/14/17	(H)	RES AT 3:00 PM BARNES 124
03/14/17	(H)	-- Continued from 3/13/17 Meeting at 1:00 PM --
03/15/17	(H)	RES RPT CS(RES) NT 4DP 4DNP 1AM
03/15/17	(H)	DP: PARISH, DRUMMOND, JOSEPHSON, TARR
03/15/17	(H)	DNP: TALERICO, BIRCH, RAUSCHER, JOHNSON
03/15/17	(H)	AM: WESTLAKE
03/20/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/20/17	(H)	Heard & Held
03/20/17	(H)	MINUTE(FIN)
03/21/17	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
03/21/17	(H)	Heard & Held
03/21/17	(H)	MINUTE(FIN)
03/21/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/21/17	(H)	Heard & Held
03/21/17	(H)	MINUTE(FIN)
03/22/17	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
03/22/17	(H)	-- Continued from 3/21/17 at 1:30 PM --
03/22/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/22/17	(H)	Heard & Held
03/22/17	(H)	MINUTE(FIN)
03/23/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/23/17	(H)	Heard & Held
03/23/17	(H)	MINUTE(FIN)
03/24/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/24/17	(H)	Heard & Held
03/24/17	(H)	MINUTE(FIN)
03/25/17	(H)	FIN AT 10:00 AM HOUSE FINANCE 519
03/25/17	(H)	Heard & Held
03/25/17	(H)	MINUTE(FIN)
03/27/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
03/27/17	(H)	Heard & Held
03/27/17	(H)	MINUTE(FIN)
04/07/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
04/07/17	(H)	Heard & Held
04/07/17	(H)	MINUTE(FIN)
04/08/17	(H)	FIN AT 1:00 PM HOUSE FINANCE 519
04/08/17	(H)	Moved CSHB 111(FIN) Out of Committee
04/08/17	(H)	MINUTE(FIN)

04/09/17	(H)	FIN RPT CS(FIN) NT 4DP 4DNP 2NR 1AM
04/09/17	(H)	DP: GARA, GUTTENBERG, SEATON, FOSTER
04/09/17	(H)	DNP: WILSON, THOMPSON, PRUITT, TILTON
04/09/17	(H)	NR: ORTIZ, GRENN
04/09/17	(H)	AM: KAWASAKI
04/10/17	(H)	MOVED TO BOTTOM OF CALENDAR
04/11/17	(H)	TRANSMITTED TO (S)
04/11/17	(H)	VERSION: CSHB 111(FIN)(EFD FLD)
04/12/17	(S)	READ THE FIRST TIME - REFERRALS
04/12/17	(S)	RES, FIN
04/13/17	(S)	RES WAIVED PUBLIC HEARING NOTICE,RULE 23
04/13/17	(S)	FIN WAIVED PUBLIC HEARING NOTICE,RULE 23
04/14/17	(S)	RES AT 3:00 PM BUTROVICH 205
04/14/17	(S)	Heard & Held
04/14/17	(S)	MINUTE(RES)
04/15/17	(S)	RES AT 9:00 AM SENATE FINANCE 532
04/15/17	(S)	Heard & Held
04/15/17	(S)	MINUTE(RES)
04/15/17	(S)	FIN AT 9:01 AM SENATE FINANCE 532
04/15/17	(S)	<Pending Referral> Uniform Rule 23 Waived
04/15/17	(S)	FIN AT 2:00 PM SENATE FINANCE 532
04/15/17	(S)	<Pending Referral> Uniform Rule 23 Waived
04/15/17	(S)	RES AT 2:00 PM SENATE FINANCE 532
04/15/17	(S)	Heard & Held
04/15/17	(S)	MINUTE(RES)
04/17/17	(S)	RES AT 1:00 PM BUTROVICH 205
04/17/17	(S)	Heard & Held
04/17/17	(S)	MINUTE(RES)
04/17/17	(S)	RES AT 5:00 PM BUTROVICH 205
04/17/17	(S)	Heard & Held
04/17/17	(S)	MINUTE(RES)
04/18/17	(S)	RES AT 2:00 PM BUTROVICH 205
04/18/17	(S)	Heard & Held
04/18/17	(S)	MINUTE(RES)
04/19/17	(S)	RES AT 2:00 PM BUTROVICH 205

WITNESS REGISTER

ROGER MARKS, Legislative Consultant
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Discussed loss recovery: how it works under SB 21, and how it would work under some possible modifications in CSHB 111(FIN)(EFD)(FLD).

ACTION NARRATIVE

1:58:39 PM

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 1:58 p.m. Present at the call to order were Senators von Imhof, Coghill, Hughes, and Chair Giessel. Senator Meyer arrived shortly thereafter.

HB 111-OIL & GAS PRODUCTION TAX;PAYMENTS;CREDITS

2:01:28 PM

CHAIR GIESSEL announced consideration of HB 111. [CSHB 111(FIN)(efd)(fld) was before the committee.] It was heard for the first time on April 14; then two hearings on April 15, two hearings on April 17, and yesterday, April 18, the committee heard from the Department of Revenue and a legislative consultant. Today they would hear from the other legislative consultant, Mr. Roger Marks, who would talk about loss recovery and cost recovery and the different ways those play out in HB 111.

2:02:08 PM

ROGER MARKS, Legislative Consultant, Alaska State Legislature, Juneau, Alaska, testified that he was asked to discuss loss recovery, how it works under SB 21, and how it would work under some possible modifications.

2:02:49 PM

SENATOR WIELECHOWSKI joined the committee.

2:03:07 PM

MR. MARKS explained that the current tax system, SB 21, is a net tax system with a 35 percent rate. There is a floor on that net tax equal to 4 percent of the gross revenue. His examples look at North Slope non-GVR oil, but the loss mechanisms for GVR oil are similar, so there is not a lot to be gained by looking at them separately.

The definition of loss recovery (slide 3) is when 35 percent of loss value is used to reduce taxes in future years. So, if he has $50 in income, $50 in gross revenue and $150 in costs, he has a $100-loss. At the tax rate of 35 percent, the value of that loss is $35 in terms of being able to deduct it.

2:04:37 PM
Slide 4 illustrates how losses are recovered under SB 21. First, there is a floor of zero on the production tax value (PTV), which is the same as the net value less the upstream costs. A loss is a cost (upstream "lease expenditure") that is not deductible in calculating the PTV (because the PTV has a floor of zero). If a company's gross value is $20, and upstream lease expenditures are $25, it can only use $20 to get down to zero PTV. So, $5 of that is a loss. Under SB 21 losses are recovered where 35 percent of the losses become a credit.

Three things can be done with a credit: it can be carried forward to reduce taxes in future years, it can be sold to another taxpayer (transferable credits), and that hasn't had an active market since its inception in 2006, or if the taxpayer qualifies to be cashed out by the state with limitations.

The losses under SB 21 can bring the tax below the gross floor to zero and any unused credits can be carried forward.

2:06:49 PM
Slide 5 illustrated how a loss is generated under SB 21 in Year 1 as follows:

ANS Price $30
Transportation Cost ($10)
Gross Value $20
Upstream Costs ($25)
PTV $0
Loss $5
  Loss Carryforward Credit (LCFC)
  35 percent of loss $1.75

2:07:30 PM
CHAIR GIESSEL asked where royalty comes into play.

MR. MARKS replied that basically one has royalty barrels and non-royalty or taxable barrels. Here he is talking about the taxable barrels. So, in the case of a 1/8 royalty contract, if a company produces eight barrels, it will write a check for 12.5 percent of the value of one barrel, and then the seven barrels are subject to the exercise on slide 5. The upstream costs are the costs associated with producing both royalty and non-royalty barrels.

CHAIR GIESSEL asked how long it takes for a company to ask for royalty relief.

MR. MARKS answered it takes a lot of time and effort and involves reviewing of a lot of material. Of the companies that have gotten royalty relief, he wasn't familiar with the timeframe involved.

2:09:08 PM
Slide 6 illustrated how a loss is generated under SB 21 in Year 2 as follows:

ANS Price $55
Transportation Cost ($10)
Gross Value $45
Upstream Costs ($25)
PTV $20
Tax before LCFC $7
LCFC ($1.75)
Tax before p/bbl credit $5.25
Per barrel credit ($3.45)
Tax $1.80

Gross minimum $1.80

2:11:16 PM
He was asked to analyze the modifications (slide 7).
1. Instead of converting the loss to a credit at 35 percent the loss itself is carried forward and deducted along with the other lease expenditures:
-no longer refundable
-no longer transferable: losses stay with the company that earned it

He said there is no mathematical difference between giving a credit of 35 percent of the loss or deducting the gross amount of the loss and subjecting it to a 35 percent tax rate. That would be illustrated in the next slides.

2. The floor is hardened: can't use losses to bring below the gross minimum. Unused losses can, with some exceptions, still be carried forward just as in the current SB 21.

2:13:09 PM

Slide 8 illustrated how under these modifications a loss could be generated using the same assumptions under SB 21 (a few slides back).

Generating a Loss: Year 1

ANS Price $30
Transportation Cost ($10)
Gross Value $20
Upstream Costs ($25)
PTV $0
Loss $5
Loss of $5 (instead of converting this loss to a credit at a 35 percent rate), is carried forward to the next year.

2:13:49 PM
Slide 9 illustrates how the tax is calculated using this modification Year 2: Carrying the Loss Forward @ $55 Price

ANS Price $55
Transportation Cost ($10)
Gross Value $45
Upstream Costs ($25)
PTV $20 (Under the current regime, since the loss that was carried forward had already been subjected to a 35 percent rate, he calculated the 35 percent tax and then deducted credit.)

Loss carried forward ($5)
Tax base $15
Tax before per barrel credit of $5.25
Per barrel credit (only $3.45 of the $8 credit can be used bringing the Tax to $1.80 (equal to the gross minimum floor with a 45 percent gross.)

MR. MARKS explained with GVR oil, a company can use the per barrel credit to bring its tax below the gross floor, but that doesn't affect the loss recovery mechanism. That's what happens at a price of $55, and since the loss carried forward credits don’t bring the tax below the gross floor, the answer is the same under SB 21 and these modifications.

2:15:58 PM
CHAIR GIESSEL commented that he was basically taking slide 6 and comparing it to slide 9 and saying the result is the same.

MR. MARKS answered yes, adding that the reason one gets the same result is because there are two different ways of monetizing a $5 loss under the modifications.

CHAIR GIESSEL commented that neither one of those brings the loss below the 4 percent minimum tax floor.

2:17:16 PM
MR. MARKS agreed, and said he would show what happens at lower prices.

SENATOR VON IMHOF asked what his models showed at oil prices of $60, $65, and $70.

MR. MARKS replied they show the same result.

2:18:44 PM
Slide 10 illustrated SB 21 Year 2: using the Loss Credit at a price of $40:

ANS Price $40
Transportation Cost ($10)
Gross Value $30
Upstream Costs ($25)
PTV $5
Tax before LCFC $1.75
LCFC ($1.75)
Tax before p/bbl credit $0.00
Per barrel credit ($0.00)
Tax $0
Gross minimum $1.20

Under SB 21 a company can use its loss credits to bring the tax below the gross, which is what happened in this example.

2:20:52 PM
Slide 11 illustrated what would happen at $40 using the two modifications in Year 2:

ANS Price $40
Transportation Cost ($10)
Gross Value $30
Upstream Costs ($25)
PTV $5
Loss of $5 carried forward ($1.57) (He explained that under this modification you can't bring your taxes below the gross floor,

so he "back calculated" the loss carried forward to get to the gross floor. That is $1.57.)
Tax base $3.43 (subjected to a 35 percent tax rate)
Tax before p/bbl credit $1.20
Per barrel credit ($0.00)
Tax $1.20
Gross minimum $1.20

He explained that the LCFC could not bring tax below the gross minimum tax, because it increases under the proposal from $0 to the gross minimum.

2:23:38 PM
CHAIR GIESSEL asked if the example on slide 11 had the choice of using the loss carry forwards in total or maximizing them and foregoing the per barrel credit.

MR. MARKS answered that according to a department advisory bulletin, SB 21 addresses the order in which the credits can be used, and loss credits are used first. Then the per barrel credit is used. If the proposed mechanism used the same order, there wouldn't be a choice. Right now, one can't use the per-barrel credit to bring tax below the floor, and if one can't use either the loss or the per-barrel credit to bring tax below the floor, he didn't think it would make a difference which order was used, because at the end of the day the tax would be $1.20.

CHAIR GIESSEL added that would be because in this concept the floor is hardened.

MR. MARKS replied, "exactly."

2:25:49 PM
He pointed out under the current SB 21, for the GVR oil, one could use the specific per barrel credit for that oil to bring the tax all the way down to zero. Economically, that is a "very important provision" given the challenges that GVR oil faces. Under the proposal, a floor is articulated on how far one can carry losses, but not on a per-barrel credit, and the order in which those are used may matter. That should be considered.

CHAIR GIESSEL asked if the loss carry-forward could be carried forward.

MR. MARKS responded if a company generates a loss - slide 8 generates a $5 loss - any loss you can't use in one year, you can carry forward to subsequent years.

2:28:05 PM
CHAIR GIESSEL said on Saturday, Mr. Marks presented slides about a competitiveness boundary between different taxing jurisdictions for oil. She asked what factors he used to establish it. Was it solely this numeric calculation in the tax policies?

MR. MARKS replied that question has a lot of aspects. On Saturday, he "sort of scratched the surface" on the logic he used, and asked if she meant for him to discuss the role and limitations of using "government take."

CHAIR GIESSEL answered yes. She wanted to know how the modifications discussed in this hearing would change Alaska in terms of competitiveness.

MR. MARKS asked if he should talk a little bit about the roles of using government take and competition in establishing a fiscal system.

CHAIR GIESSEL answered yes.

2:30:45 PM
MR. MARKS said if a person examines anything, he circles it and looks at it from a lot of different angles: cash flow to the state, cash flow to taxpayer, efficiency of operations, timing of revenue, cost recovery, how risk/reward balance is shared, for instance.

A very important aspect of that examination is how Alaska's tax system compares to other jurisdictions. Stepping back further, he said in 1959, the state got statehood and in 1962 the state was trying to figure out how to develop the North Slope. It could have started its own state-owned oil company, but people decided to bring the experience, the expertise, and the resources of the international oil community to Alaska to drill on the North Slope. That's the point at which development on the North Slope became subject to the forces of competition, and over the years those forces have intensified. The Soviet Union broke up in 1989, and that opened a lot of resources that were closed before, and world-wide competition became much more intense. Technology has increased, as well, and oil is found in more places further intensifying the competition. There is capital to develop these resources, but capital is very fluid. It is also finite, and so it will go where it gets the best deal.

What is meant by fair share? Mr. Marks said over the last 35 years. he has thought that a big part of fair share is being able to get a similar amount of money to what other similar places get, just because of the forces of competition. So, any fiscal evaluation requires a systematic examination of the competition, and government take is a tool to do that. While it is imperfect, it is used by many economists.

MR. MARKS said net present value (NPV) is a primary metric that companies use in picking out where they want to invest. A larger field with a low rate of return can be much more useful in making a company grow than a small field with a high rate of return. The difference in value is two things: money and timing of how it flows, and government take is a big part of the money side of that equation.

Using government take requires some judgement, and one element of that judgement is what peer group an analyst is going to use. On Saturday, he talked about how he developed his peer group in terms of their similarities, but he didn't talk about countries that were not in that peer group and why, but maybe it would be useful to talk about them now.

2:35:53 PM
MR. MARKS said he could think of four jurisdictions as perfect examples of what he didn't include. Ireland is one; it comes out with the lowest government take in the world, but the industry joke is that it has no oil. Kazakhstan and Azerbaijan have spectacular resources at low cost, but they have very high government take, because they can command it (their resources are so good, and their costs to develop are so low). Iraq has high government take, but they have development contracts called technical service contracts. These came into play in Iran after the Iran/Iraq war when a lot of fields were damaged, and Iraq wanted them repaired. Iraq instituted the technical service contracts, under which if a company gets a field up and running, it gets reimbursed dollar for dollar. All its costs get reimbursed, including many costs that have a profit component, and then it gets a fixed amount of dollars per barrel for every barrel that gets produced. BP bid a lot of these for $1/barrel. They don't have to pay any royalties or production tax; maybe some corporate income tax. The rate of return on getting reimbursed right away, plus $1 dollar, is infinity.

Caelus, for example, has this world class discovery on the western North Slope, and what if for some reason they walked away from that and the state wanted it developed. So, the state says we're going to develop in the following way: we're going to reimburse every dollar you put into it, plus $1/barrel. That would be high government take, but companies would be lining up around the block to get into that field. The bottom line is it would not be appropriate to have those jurisdictions in the peer group. That is what he means by "judgement."

2:39:17 PM
MR. MARKS said in 2013, three economists were working for the administration on ACES; all three of them separately looked at government take and found that something was "very very wrong." Similar groups were getting somewhere around 60-65 percent and SB 21 was crafted to come in around that at higher prices. The last DOR Sources Book two years after the ACES regime when SB 21 was in effect indicates production was up by 50-60,000 barrels. Everyone knew the oil was there, but companies were not developing it, because under ACES, there was no upside potential (which was reflected in the government take). So, under high prices comparing ACES to SB 21 with 50-60,000 more barrels, the state is getting more money under SB 21. The effect it had focus was changing the government take.

In the exercise of looking for a peer group, Mr. Marks said he looked at how a country was established and took an average of government take at $40-100/barrel. He added that although using government take is an imperfect tool, most economists acknowledge that it is a very useful tool with which to look at competition.

2:42:30 PM
SENATOR HUGHES asked if Alaska moves from a credit system where the loss is subtracted from the tax to a deduction system, subtracting it from the production tax value, and wants to keep the competitive boundary in mind, what he would advise them to do.

MR. MARKS replied that he had not modeled these modifications by themselves, so that could be a request through Legislative Budget and Audit (LB&A). It would be a simple exercise and would not take long.

CHAIR GIESSEL asked if she should request that.

SENATOR HUGHES answered yes.

SENATOR VON IMHOF said yesterday another presenter talked about using the per-barrel credits and the NOLs together where the NOL would go as far as they could and then the per barrel credits would kick in. That means the state could get more of the NOLs forwarded to subsequent years. She asked Chair Giessel if she would also request that Mr. Marks compare that with what he is presented here over a two or three-year period using a couple different price points.

MR. MARKS answered he would be happy to do that.

CHAIR GIESSEL said she would make that request, and asked if that is what slide 11 did.

MR. MARKS responded the question is probably about how the per-barrel credit would interact with the minimum floor.

CHAIR GIESSEL said that Senator von Imhof's question was what happens with the NOLs if only part of them ($1.57 of the $5) is being used, and rolling the remainder forward in year 3 when maybe the Alaska North Slope crude price has gone up.

2:46:43 PM
MR. MARKS reminded the committee that these losses were generally at $30. The losses for GVR oil would be generated at higher prices. Ultimately, generating a loss, unless prices stay really low for a long time and then recover, the issue is timing and finding a net present value (NPV). So, the question is how firm to make the floor, and the policy question then becomes if the floor is "sacred" or not. If one wants to keep the floor perforated, or eliminate it, it's important to understand those are policy calls.

CHAIR GIESSEL said that was a good point that LCF would not be an issue at higher prices in non-GVR scenarios, because companies would reduce their costs to no longer be at a loss. It would be interesting to consider that under the GVR scenario, as well.

MR. MARKS reminded the committee that GVR oil has the $5/barrel credit provision to bring tax down to zero. In his judgement, given the challenges of GVR oil, that is a useful feature of SB 21.

2:51:02 PM
SENATOR VON IMHOF said the challenge legislators have is ending the state purchasing program for these cash certificates, but it

has a large amount of cashable credits in limbo, and the questions is what to do with those while modeling what the future may look like with newly generated NOLs. Does it make sense to "rev-up this third-party taxpayer market," and can he create that within his model?

MR. MARKS divided that up into two questions: what to do about the $1 billion in unpaid credits and how to use the market of taxpayers being able to sell their credits. The reasons the transferable credit market never took off are twofold: one from the seller and one from the buyer. If the seller had $100 tax credit, the way it would work is someone would buy that credit and then they could use it to take $100 off their taxes. The problem is that it made no sense to pay face value for that, so the buyers were low-balling the holders of the credits. That is why the refundable program was put in place in 2007, where the state started buying credits at 100 cents on the dollar. So, one of the problems with transferable credits is that buyers don't get face value for them.

On the buyers' side, the reason the market never took off is those credits had a lot of limitations on what could be done with them: what year they could be used, or how much could be used, for instance.

What to do with the $1 billion cashable credit balance? Given the state's cash flow situation, that is a big problem. Mr. Marks said one way would be pay it out very slowly over time, although that obviously has a net present value impact. But if the state were to write a check for $1 billion right now for those, it would make the budget debate even more difficult.

2:55:47 PM
SENATOR MEYER said the reason legislators went to SB 21 was to come up with a tax system that had four pillars: it's fair, simple, durable, and creates more production. He wasn't sure it was all that simple, but the proposed changes in HB 111 might make it even more complex. He asked if Mr. Marks had any suggestions on what could be done to it to meet those four goals while making Alaska competitive.

MR. MARKS replied that a lot of things need to be balanced in establishing a tax system, and government take is not the bottom line. Competitiveness is another dimension, and SB 21 is competitive. If the issue is the gross minimum and whether the state should be getting revenue no matter what, it is already getting the royalty no matter what. That royalty is based on gross, at high prices, which affects owners of expensive assets.

But the state has the budget to look at, as well, and another dimension is the question of if fiscal stability is changing the system. Since prices have dropped, some jurisdictions have modified their systems. Alberta has a very complicated royalty system (they don't have production taxes), and it gets changed frequently as prices go up and down. It is a fairly progressive system. In general, companies expect tax changes maybe every 10 years, but changing it a lot creates instability. He recalled advising five different governors on the gas line that the first thing they should do is get a constitutional amendment for fiscal stability, because no one is going to spend $50 billion, and then once the asset is in place, have something like ACES happen to it where all the value the state thought it would get was taken away.

He said, "Sometimes there is a price to pay for not changing taxes, but sometimes there's a price to pay for changing them, and there's some value in just letting something, albeit imperfect, just dissipate for a while rather than constantly modifying it."

SENATOR MEYER said SB 21 meets three of the goals, but asked if there is a way to make the tax structure simpler, the one thing it isn't.

MR. MARKS answered that he needed to think about that for a while before issuing a judgement.

SENATOR MEYER suggested he send an email to the chairman who would distribute it.

CHAIR GIESSEL said she still has the four pillars from SB 21, and the bullet point of "fair" stated "fair to Alaska" and the "simple" pillar talked about "being balanced."

3:03:01 PM
SENATOR COGHILL thanked Mr. Marks for "being willing to go another round with us" on making sure value is brought out of this field. He said that the credit system under SB 21 can't be maintained, but legislators also want to retain some value for those on the North Slope who have already made some huge commitments, whether it's a march down in their credits or a recognition of investment value. Yesterday, one of their consultants said price sensitivity will continue to distort that

value, because Alaska goes in and out of a gross and net system on a regular basis. The idea was to retain the value of the NOLs into the future, but some of the mechanisms in SB 21 make that complicated, and throwing cash into the budget only to get vetoed by the Governor is not a good systemic way to move forward.

He said one of the ways the system returns value for investment is by using a variable per-barrel credit that is price sensitive, and asked if Mr. Marks had thought through a way to get that based on a principal rather than a price.

MR. MARKS asked if he was referring to the sliding-scale, per-barrel credit.

SENATOR COGHILL answered yes. He is trying to get a clearer picture of how to keep the value for those who have invested as the state "marches down" its cash investment.

MR. MARKS said he didn't understand his question, but the sliding-scale, per-barrel credit was the way to offset the high royalties at low prices. As the price goes up and royalty becomes less of an issue, the credit goes down. One of the imperfections of the sliding-scale credit is that it is dollar-based rather than being a percentage of something. "Having something fixed in the code that is a set per-dollar amount eventually will stop doing what you want it to do for one reason or another."

SENATOR COGHILL commented that it seems like they are trying to not pay some of these credits, but still let people retain value for investment, and the current complex system has so many moving pieces to it that he is still trying to understand it. He was probably asking his question "in-artfully," and decided to withdraw it.

MR. MARKS replied the he would be delighted to discuss this with him any time.

CHAIR GIESSEL remarked that can happen by going through the Legislative Budget and Audit Committee (LB&A).

CHAIR GIESSEL thanked Mr. Marks for his presentation and said as the state faces this fiscal challenge and as she thought about the tax structure over the last three years, she convened the Tax Credit Working Group with senators from Resources and Finance Committees, Native corporations, industry, and labor.

They began to "wrestle with" the credit system focusing on Cook Inlet at that time, because that was where most of the cashable credits were going.

She divided this topic into three buckets: the $700 million in cashable credits that are now worthless, and that the Senate seriously wants to solve, what to do going forward in terms of accruing more debt in these cashable credits, and reviewing SB 21 (the Senate believes it is working).

She said now they have found that because of this incredibly complex system and the way the credits work, the floor isn't hard, so that must be dealt with. However, changing one element affects other elements, so it is a challenge.

CHAIR GIESSEL said she would forward the questions generated today through the LB&A process to Mr. Marks and Mr. Ruggiero, legislative consultants.

3:14:31 PM
CHAIR GIESSEL adjourned the Senate Resources Committee meeting at 3:14 p.m.