

SENATE FINANCE COMMITTEE
March 18, 2019
9:01 a.m.

9:01:05 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:01 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Lyman Hoffman
Senator Peter Micciche
Senator Donny Olson
Senator Mike Shower
Senator Bill Wielechowski
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel; Senator Mia Costello; Senator Gary Stevens; Senator Chris Birch; Bruce Tangeman, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Ed King, Chief Economist, Office of Management and Budget.

PRESENT VIA TELECONFERENCE

Colleen Glover, Director, Tax Division, Department of Revenue

SUMMARY

PRESENTATION: SPRING REVENUE FORECAST

OIL & GAS PRODUCTION TAX AUDIT UPDATE

Co-Chair Stedman discussed housekeeping.

^PRESENTATION: SPRING REVENUE FORECAST

OIL & GAS PRODUCTION TAX AUDIT UPDATE

9:03:05 AM

BRUCE TANGEMAN, COMMISSIONER, DEPARTMENT OF REVENUE, stated he would be reviewing the spring update, which was an update to the more robust fall forecast. He had not seen notable changes to the fall forecast. He noted that the price from the fall had risen approximately \$1 for FY2019. The FY2020 oil price had been shown at \$64 and had gone up to \$66; the outyears were the same. Production for FY 2019 was slightly down and expected to be slightly down for FY 2020.

9:04:36 AM

Commissioner Tangeman discussed the presentation "Spring 2019 Revenue Forecast Update," (copy on file).

Commissioner Tangeman turned to Slide 2, "Overview":

- Revenue Forecast & Changes from Fall Forecast
- ANS Oil Price Forecast
- Oil Production Forecast
- North Slope Lease Expenditures Forecast
- Oil Credits Forecast & Tax Bonding Update

Commissioner Tangeman showed Slide 3, "Spring 2019 Revenue Forecast."

Commissioner Tangeman stated he would speak to the revenue forecast fall to spring changes. He would speak briefly to the oil production forecast but that more details could be made available from the Department of Natural Resources. He relayed would discuss North Slope Lease expenditures update.

9:05:22 AM

Commissioner Tangeman displayed Slide 4, "10- year Revenue Forecast and Comparison to Fall Forecast," which showed a series of data tables that illustrated the delta between

unrestricted general fund petroleum revenue (UGF), non-petroleum revenue, and total revenue, with the permanent fund transfer from SB 26 legislation. He pointed out the decrease in FY2019 of \$89 million for FY2019 in UGF, with an increase in FY2020 of \$39 million. He reiterated that there was not much change expected in the revenue forecast for the next decade.

[9:06:35 AM](#)

Co-Chair Stedman thought that although it would be of some interest to see out to FY 28, the committee was focused on the FY2019 through FY2021 numbers. He asked for a rough idea of how the total for FY2019 and FY2020 was split amongst its components.

[9:07:13 AM](#)

Commissioner Tangeman discussed Slide 5, "Reasons for Changes to FY19 / FY20 Unrestricted Revenue forecast":

FY19 unrestricted revenue forecast is reduced by about \$89m compared to the fall forecast, despite higher forecasted near-term oil prices. The primary changes to the FY19 forecast are:

•**Production Tax reduced by \$80m:**

•**Higher Oil Prices**, though partially offset by lower production, increased the production tax forecast by \$25m.

•**Lower than Expected FERC payments, Higher than Expected Refunds, and other Company-Specific items** reduced the production tax forecast by \$105m.

•**Non-Petroleum CIT reduced by \$15m** due to lower than expected payments in December 2018.

•**Other revenues reduced by \$2m** due to a variety of smaller nonpetroleum forecast changes.

•**Royalties increased by \$8m** due to higher oil prices and despite lower production.

The unrestricted revenue forecast for FY20 is increased by about \$39m compared to the fall forecast. The primary changes to the FY20 forecast are:

•**Production Tax increased by \$45m** due to higher prices, partially offset by lower production.

- **Royalties increased by \$19m** due to higher oil prices and despite lower production.
- **Non-Petroleum CIT reduced by \$15m** primarily due to weaker nonprecious minerals prices.
- **Other revenues reduced by \$10m** due to a variety of smaller nonpetroleum forecast changes.

Commissioner Tangeman explained that the numbers netted out to the reduction of \$89 million in FY2019 and \$39 million in FY2020.

[9:09:29 AM](#)

Co-Chair Stedman asked about Federal Energy Regulatory Commission (FERC) payments mentioned by Commissioner Tangeman and noted that the state did not make payment to FERC.

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, explained that there was a settlement of some prior year tariff calculations pertaining to how tariffs for the Trans-Alaska Pipeline System (TAPS) were determined. He explained that the dispute involved FERC. There had been multiple years of calculations for which the agreement of a methodology for making the TAPS tariff calculations had been settled. The Department of Revenue had done some modelling and had determined an estimate of the receipts of \$160 million for FY2019. He said that the actual receipts came in at approximately half of what had been expected.

[9:11:09 AM](#)

Co-Chair Stedman asked where the funds were received.

Mr. Stickel stated it was General Fund (GF) money that came to the state.

Co-Chair Stedman asked for an explanation in greater detail.

Mr. Stickel explicated that the funds had to do with the tariffs that were deducted when calculating prior years taxes. He used the example of 2014, when producers used a certain tax tariff to arrive at their gross value and their net value, they paid the tax based on the tariff used at that time. He said that the settlement resulted in a

slightly lower TAPS tariff for that calendar year, so producers had refiled their taxes using the lower TAPS tariff, resulting in a higher net and gross value and additional tax liability to the state. Along with the refiled, there would be additional tax liability and make an additional payment or use credits to offset the liability.

[9:12:33 AM](#)

Co-Chair Stedman summarized that as the cost of running TAPS fluctuated it effected the net value because it was under a net tax, which moves tax receipts up or down depending on the settlement. He stated that the expectation from the original forecast had not turned out as robust as anticipated, which resulted in the adjustment.

Mr. Stickel answered in the affirmative.

[9:13:08 AM](#)

Co-Chair von Imhof asked about "higher than expected refunds" as listed on Slide 5.

Mr. Stickel replied that the language pertained to the migrating credits issue surrounding the SB 21 tax regime. He stated that companies gave an estimated payment on a monthly basis based on the amount of per taxable barrel credits that could be applied against production tax in a particular month. At the end of the year there was a "true-up"; if there had been price volatility during the year, any per taxable barrel of credits unused in each month of low prices could be applied to higher priced months. The current years forecast showed some higher priced months in the middle of 2018, and then prices fell substantially. The companies were able to take some credits earned in December and apply them to earlier month in that year. He said that the state was forecasting approximately \$50 million in refunds to be paid out within the next two months.

[9:14:52 AM](#)

Senator Hoffman asked about the tax settlement and asked if any of the funds went to the Constitutional Budget Reserve (CBR).

Mr. Stickel informed that the settlement of the tax dispute went to the CBR; however, the TAPS issue was an issue of the TAPS tariff outside the tax calculation and was deemed to be outside subject to the CBR deposit and would be treated a general fund for forecast purposes.

[9:15:51 AM](#)

Senator Hoffman asked who had handed down the legal opinion.

Mr. Stickel stated the information came from the previous attorney general, Craig Richards.

Co-Chair Stedman thought there was a difference of opinion and an interest in further research to review the decision regarding funds going to the CBR. He shared that technically the CBR was general funds but required a three-quarter legislative vote to access the funds, rather than a simple majority. He shared the concern was that the settlements would be deposited directly into the general fund which could artificially lower or raise the deficit and effect budgetary decision making.

Co-Chair Stedman referenced Senator Hoffman's point, and stated the members would engage in discussions on the matter.

[9:17:53 AM](#)

Senator Hoffman stated the legislature could take general funds and put them in the CBR because the account was owed millions of dollars.

Co-Chair Stedman thought Senator Hoffman had made an accurate statement. He hoped for an agreed position between the two branches of government.

[9:18:21 AM](#)

Senator Micciche understood there was a 50-50 split between the FERC settlement adjustment and the per barrel annual "true up."

Mr. Stickel replied that the FERC payment was the largest piece; the higher than expected refunds was approximately

\$20 million, the company specific payments was nearly \$30, so the FERC shortfall was about \$50 million.

Senator Micciche understood the FERC shortfall was merely a miscalculation.

Mr. Stickel stated that DOR had known that that settlement had taken place and that the companies would be refiling tax returns. He said that the department had gone through each companies' specific calculation and had estimated what the "true up" liability would be, with interest.

Commissioner Tangeman clarified that he would not characterize the difference as a miscalculation; but rather as a change in the forecast amount.

[9:20:01 AM](#)

Senator Wielechowski queried the effective oil and gas production tax rate in FY2020.

Mr. Stickel responded that he did not have the calculation. He agreed to provide the information.

Co-Chair Stedman stated that there would be a fiscal year cash flow comparison through 2021 on Friday. He said that the effective tax rates could be examined then for varying degrees of price and production.

Co-Chair Stedman noted that the subcommittee chaired by Senator Wilson was working on settlement issues and potential revenue. Senator Wilson would bring the full committee information to consider.

[9:22:18 AM](#)

Senator Wielechowski referenced the Executive Budget Act which required the governor to submit a 10-year fiscal plan each December. He noted that the document had yet to be provided to the legislature and wondered when it was expected to be available.

Commissioner Tangeman stated that the governor's office had the document in final draft form and would present it within the week.

Co-Chair Stedman interjected that he was not excited about the 10-year plan but was more concerned about getting through the medium long-term and the short-term. He felt that the long-term forecasting used in the ten-year plan offered minimal value to the committee. He hoped that the committee could focus more closely on the short term.

[9:23:41 AM](#)

Senator Micciche asked if DOR could explain the \$89 million reduction in FY2019.

Commissioner Tangeman responded that the FY2019 budget had passed with the three-quarter CBR vote with a per barrel forecast of \$63.

Co-Chair Stedman asked for an explanation to inform the public of the details of the inner play between the forecast and the budgetary process.

Commissioner Tangeman relayed that when the legislature passed the FY2019 budget the previous spring; there had been a forecast of \$63/bbl, with a projected \$700 million deficit. He added that legislation had passed enacting a percent of market value (POMV) draw (SB 26), and since this was the first time that the earnings reserve of the permanent fund was being accessed through a structured process, both the executive and legislative branches wanted to make sure that revenues drawn down earlier were those earning a lower return. He furthered that the CBR was a liquid account that earned a low return and the earnings reserve was geared toward earning a higher, more long-term, return.

Commissioner Tangeman continued that there was language put in the legislation to ensure the CBR was accessed first, with a process set up between the permanent funds and the Department of Revenue to draw down, as required, from the earnings reserve. He related this set the stage on the process of accessing both the CBR and the earnings reserve to bring enough revenue to cover the FY2019 budget. He said that currently, the price of oil was well above \$63/bbl, the forecast was \$69/bbl; however, the full amount had been drawn down from the CBR at the beginning of the fiscal year and several cash calls had been made from the earnings reserve. He clarified that while the \$89 million might look like a possible supplemental, there was still revenue

available to cover the reduction, based on the forecast that had been put in place and the budget that had been passed. There was enough revenue to cover the FY2019 budget.

Co-Chair Stedman clarified that the net number would be a smaller negative number for FY2019, which would increase the CBR by \$300 million to \$400 million.

[9:27:42 AM](#)

Senator Wielechowski referenced SB 26 and the POMV draw. He shared that the Alaska Permanent Fund balance sheet from January 2018 showed the total fund balance was \$66 billion and \$63 billion in January of 2019. He stated that the draw was going from \$2.7 billion to \$2.9 billion and wondered whether the decrease of the balance and increase of the draw was a flaw in the system.

Commissioner Tangeman would not characterize the situation as a flaw. He thought the balance would change from quarter to quarter depending on the market. He reminded Senator Wielechowski that the POMV calculation was based on a smoothed five-year average.

Co-Chair Stedman interjected there were many moving parts to the issue. He agreed that the portion that was used for dividends and state services was an average of historical values.

[9:29:40 AM](#)

Commissioner Tangeman showed Slide 6, "ANS Oil Price Forecast."

Commissioner Tangeman reviewed Slide 7, "Price Forecast Summary," which showed a table entitled "ANS Price Forecast -Change from Fall 2018 Forecast." He reminded that there was quite a bit of volatility in the fall of 2018; when prices ranged from \$80/bbl to \$50/bbl. The price forecasting session that took place amidst the fluctuations caused a higher price forecasting by the previous administration. The new administration reviewed recent happenings and put in place what it thought was a more realistic forecast.

Commissioner Tangeman said that the spring 2018 forecast had been implemented for the fall 2018 forecast and was reflected on the slide through 2028. He pointed out that the spring 2019 forecast showed an increase of approximately \$1 in the price of oil. He highlighted the biggest change was the 2020 forecasted increase of 3 percent.

[9:32:41 AM](#)

AT EASE

[9:32:50 AM](#)

RECONVENED

Commissioner Tangeman spoke to Slide 8, "Reasons for Revising the Fall 2018 Oil Price Forecast":

- DOR revised the oil price forecast for FY19 and FY20 up to align with current futures market prices (NYMEX).
- NYMEX has been shown to be one of the best methods of predicting oil prices in the near-term.
- Long-term (FY 21+) oil price forecast remains unchanged from the fall.
- Real (in 2019 dollars) price forecast for FY2021+ remains in the low to mid \$60's.

[9:34:23 AM](#)

ED KING, CHIEF ECONOMIST, OFFICE OF MANAGEMENT AND BUDGET, presented Slide 9, "Potential Macroeconomic and Global Drivers of Price Change":

A speculative and non-exhaustive list of things that could happen beyond Alaska which could affect ANS oil prices.

Potential Macroeconomic Drivers:

- 1. Recession.** Global growth could be disrupted by recession, pushing down demand. (-)
- 2. China.** Chinese economic growth could drive up demand if/when trade dispute is resolved. (+)

Potential Microeconomic Drivers:

1. **New fields.** New energy resources could be developed, increasing supply. (-)
2. **Shale.** Shale producers could hit capacity limits, allowing demand to surpass supply. (+)
3. **Production technology.** More efficient production technology could increase supply. (-)
4. **Vehicle efficiency.** Emerging transportation tech could lower demand for fossil fuels. (-)

Potential Geopolitical Drivers:

1. **OPEC / Saudi Arabia.** OPEC and/or SA could enforce higher or lower production levels. (?)
2. **Iran.** Sanction waiver renewals could be denied, reducing supply. (+)
3. **Regime change.** Iran/Venezuela regime change could occur, disrupting supply. (+)
4. **Venezuelan recovery.** State-owned PDVSA could stabilize operations, increasing supply. (-)

Mr. King thought that upward price pressure would continue through the next three months. He stressed that the department did not know what was going to happen in the future and that there were a lot of things that would prove their forecast wrong.

[9:36:34 AM](#)

Mr. King referenced slide 10, "EIA Annual Energy Outlook Price Forecast," which showed a line graph entitled "Real (Inflation-adjusted) Oil Prices and Forecasts." He explained that the Energy Information Agency forecast had been released in January 2019, it provided the range of potential future pricing on which the department was focusing.

[9:37:02 AM](#)

Mr. King discussed Slide 11, "Petroleum Analyst Consensus Price Forecasts," which showed a line graph entitled "Real (Inflation-adjusted) Oil Prices and Forecasts." He did not think there should be anything alarming in the forecast. He felt that the current forecast was online with what analysts and markets were predicting. He believed that for budgeting purposes the numbers were supported by the fundamentals.

[9:37:29 AM](#)

Mr. King turned to Slide 12, "Summary of Price Forecasts," which showed a line graph entitled "Real (Inflation-adjusted) Oil Prices and Forecasts." He noted that the current, near-term forecast followed the NYMEX curve because the department was using the curve as the best indicator of near-term prices. He noted that NYMEX discounted prices the further out into the future it predicted, which was not the best predictor of long-term prices, so the state was still analyzing the best way to determine what the long-term prices would be; however, the current forecast was still in-line with analyst expectations.

[9:37:58 AM](#)

Co-Chair von Imhof looked at Slide 7 and Slide 12. She noted that the projected spring forecast for 2020 through 2022 was in the \$66-\$67/bbl range, while the line graph on Slide 12, illustrating the same forecast seemed to reflect \$62-\$63/bbl.

Mr. King pointed out that the numbers on Slide 12 were adjusted for inflation.

[9:38:51 AM](#)

Commissioner Tangeman showed Slide 13, "Oil Production Forecast."

[9:39:13 AM](#)

AT EASE

[9:39:32 AM](#)

RECONVENED

Commissioner Tangeman displayed Slide 14, "10-Year Production Forecast: Changes since *Fall 2018 Revenue Sources Book*," which showed a line graph and table. He reiterated that the forecast was slightly down for 2019; and climbed back to forecasted numbers in 2020. He said that any in-depth conversation on the matter would be deferred to DNR.

Co-Chair Stedman asked about the oil fields Willow and Pikka, and whether they had been integrated into the analysis.

Commissioner Tangeman relayed that the department did not assume that a field would come online in 5 years as was hoped for, or that it would be at full production at the estimated time. He said that prudent way for the department to account for oil production was to put a risking mechanism in the forecast. He said that the closer to the predicted timeline, the less risk, but the further out - the more risk. He deduced that there would be an upside to larger fields coming on as expected.

[9:41:49 AM](#)

Senator Wielechowski wondered about the significantly inaccurate forecast for FY2019. He noted the 2.9 percentage change, to the negative, between the fall 2018 and spring 2019 numbers.

Commissioner Tangeman believed the 2.9 percent decrease was due to the field at Nikaitchuq being down for a period.

[9:42:26 AM](#)

Commissioner Tangeman showed Slide 15, "North Slope Lease Expenditures Forecast."

Mr. Stickel referenced Slide 16, "Lease Expenditures Forecast: North Slope Capital Expenditures," which showed a line graph entitled "Forecast: North Slope Capital Lease Expenditures." He relayed the big change made from the spring to the fall was to incorporate some development costs for some new fields such as Willow and Pikka. He said that based on new submissions from the operators about their cost plans as well as review of public information and tax returns that had been received, it appeared that the cost profile from the new developments would be higher than had been expected in the fall.

Mr. Stickel continued to address Slide 16. He stated that the significant increase up into the over \$3 billion per year in the 2021 to 2022 timeframe was when notable spending was expected on new developments. He reiterated that a risking methodology was used when incorporating the new developments and applied risk to the lease expenditure forecast as well. He said that if all the new fields came on as expected the forecast would prove to be conservative spending forecast.

Co-Chair Stedman asked about Page 106 of the Spring 2019 Revenue Forecast (copy on file) and asked whether the carry forward annual losses could be an underestimation.

Mr. Stickel replied in the affirmative.

Co-Chair Stedman contended that the figures were significant amounts.

Mr. Stickel referenced Page 13 of the forecast, which included a table that laid out the estimated tax value of carry forward losses. He reminded the committee that the numbers were based on the risked estimates of future company spending.

Co-Chair Stedman referred to the 2019 spring revenue forecast and clarified that 2023 showed an increase of \$440 million. He thought that the time was approaching to discuss how the numbers would be integrated into the cash-flow analysis, and the subsequent impacts of that integration.

Mr. Stickel stated that there would be a presentation soon that discussed the mechanics of how the carry forward losses operated.

[9:46:06 AM](#)

Senator Bishop wondered whether the revenue forecast included any ANWR spending.

Mr. Stickel confirmed that the forecast did not include ANWR in any form.

[9:46:50 AM](#)

Senator Wielechowski asked whether the tax value of carry forward annual losses on Slide 13 were not the deductions taken each year, but cumulative for companies that could not deduct them off their production taxes.

Mr. Stickel replied in the affirmative. He explained that the lease expenditures that were not able to be deducted in the year they were earned were carried forward and multiplied by the 35 percent statutory tax rate to determine the tax value.

[9:47:26 AM](#)

Mr. Stickle reviewed Slide 17, "Lease Expenditures Forecast: North Slope Operating Expenditures," which showed a line graph entitled "Forecast: North Slope Operating Lease Expenditures." He affirmed that there had been only mild adjustments to the operating expenditures forecast. He continued that operating expenditures were stable at the existing units, with a slight bump as new developments came online.

[9:48:22 AM](#)

AT EASE

[9:49:03 AM](#)

RECONVENED

Mr. Stickle spoke to Slide 18, "North Slope Transportation Costs Forecast," which showed a line graph entitled 'Forecast: North Slope Transportation Costs.' The slide showed the costs of getting oil from the field to the market. He noted an average transportation cost of \$8.41 for FY2019, increasing with inflation for the rest of the forecast.

Co-Chair Stedman asked about Mr. Stickle's previous comment about the Natural Petroleum Reserve-Alaska (NPR) not being calculated in the revenue.

Mr. Stickle clarified that some production from NPR was included in the calculation; no production or exploration costs for ANWR were included in the forecast.

Co-Chair Stedman assumed that the numbers on Slide 18 did not include the cost of transporting ANWR volume out, which could put downward pressure on the per barrel TAPS tariff.

Mr. Stickle stated that production from ANWR, or any new development, would decrease the cost per barrel of transporting oil on TAPS. He added that any quality differentials as well as feeder pipeline costs would be added into the number; the overall cost change would depend on the specific development.

[9:51:00 AM](#)

Senator Wielechowski asked about the tariff to ship oil from Point Thomsen into TAPS.

Mr. Stickel offered to provide the number later.

Co-Chair Stedman recalled that the cost had previously been \$.28.

[9:51:36 AM](#)

Senator Wielechowski asked whether the feeder lines from Point Thomson to Prudhoe Bay were lease expenditures or transportation costs.

Mr. Stickel stated that a feeder pipeline from a unit boundary would be a feeder transportation cost, a gathering line within the unit would be a lease expenditure. He offered to provide more technical information later.

[9:52:19 AM](#)

Commissioner Tangeman showed Slide 19, "Oil Credits Forecast and Tax Credit Bonding Update."

Commissioner Tangeman turned to Slide 20, "Spring 2019 Oil Credits Forecast," which showed a bar graph entitled "Ending balance of credits available for repurchase, assuming statutory appropriation for FY 2020+." He noted the liability to the state would go to zero by 2024. He relayed that \$180 million in payments was included in the FY2020 budget.

[9:53:19 AM](#)

Senator Wielechowski looked at the small print on the bottom of Slide 20:

Per AS 43.55.028, statutory appropriation is 10% of production tax levied, before credits, when ANS price forecast is \$60 or higher. Statutory appropriation is 15% of production tax levied, before credits, when ANS price forecast is below \$60. Does not include changes in company behavior or credit transfers beyond FY 2020 as a result of only making statutory appropriation.

Senator Wielechowski wondered what credits were being referred to and how much they totaled in FY2020.

Mr. Stickel informed that that the statutory appropriation shown on the slide was calculated based on the production tax due at the 35 percent net rate before subtracting any credits, including primarily per taxable barrel credits.

Senator Wielechowski asked how much the amount was scheduled to be for 2020.

Mr. Stickel stated that the per taxable barrel credit forecast for 2020 was \$1.26 billion.

Co-Chair Stedman asked whether that was the \$5 or the \$8 per barrel credit.

Mr. Stickel stated that the amount included both credits.

Co-Chair Stedman stated that there was a debate whether the calculation used to pay the credits should be on gross production tax value, before the per barrel offset, or after. He relayed that the debate had been going on for some time. He understood that the state currently had \$800 million in outstanding credits.

Commissioner Tangeman believed the amount was about \$700 million.

Co-Chair Stedman continued that the issue needed to be dealt with. The credits had been terminated and the state was not paying the liability; the debate was whether the payment should be made on a net or gross amount.

[9:56:39 AM](#)

Senator Wielechowski asked about Slide 19 and asked whether refundable oil tax credits had ever been audited.

Commissioner Tangeman deferred to the division's tax director.

COLLEEN GLOVER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, stated that the credits had been audited.

Co-Chair Stedman requested further clarification as to how the system worked.

Ms. Glover stated that credits were 100 percent audited before the state expended fund for credits.

[9:58:02 AM](#)

Senator Wielechowski asked how much money had been returned after audits over the years.

Co-Chair Stedman requested an estimate of the amount disputed after the credits had been paid, if any.

Ms. Glover offered to provide the information later.

Co-Chair Stedman requested that the information be available by the end of the week.

[9:58:43 AM](#)

Senator Bishop asked if Ms. Glover could give two examples of a qualified credit expenditure and two that would not qualify.

Ms. Glover stated that there were qualified capital expenditures and qualified lease expenditures. She elaborated that there were different types of expenditure depending on whether the work was in exploration or production.

Commissioner Tangeman interjected that the state followed federal Internal Revenue Service (IRS) code pertaining to the definition of a capital expenditure.

Co-Chair Stedman explained that the legislature used long-established IRS rules to avoid lengthy legal action and never-ending debate; there were some exclusions to protect the state. He stated the industry was able to deduct the expenditures on corporate income tax.

[10:01:02 AM](#)

Co-Chair Stedman referenced the Fall 2018 Revenue Sources Book, and the credits that were shown for the fall of 2020 were \$1.9 billion; those credits are currently forecasted at \$1.5 billion. He noted that the difference in the numbers for 2021 for statewide total production tax credits was \$500 million between the fall 2018 and spring 2019 forecasts. He asked for an explanation of the monetary swings and how one might track the amounts.

Mr. Stickel stated that the change between FY2020 and FY2021 had to do with the convention used to show outstanding repurchasable credits in the revenue sources book. He said that the fall book showed that the entire balance of outstanding credits would be paid off in FY2020, an assumption that had been informed by the bonding package, which had been delayed by litigation. He said that for purposes of the revenue forecast what was now showing was the statutory appropriation in FY2020, and the entire outstanding balance of repurchasable credits in FY2021.

Co-Chair Stedman cautioned comparing the yearly books as the numbers varied.

[10:03:25 AM](#)

Commissioner Tangeman referenced Slide 21, "Current Status of Tax Credit Bonding (HB 331)":

- House Bill 331 (HB 331) established a corporation for the purpose of financing the purchase of transferable tax credits, production tax credits, the payment of certain refunds. The Corporation is authorized to issue up to \$1 billion in subject-to-appropriation bonds. In FY2019, \$27 million was appropriated for debt service on bonds issued by the Corporation.

- Due to ongoing litigation, the Corporation has not yet issued any bonds. The Complaint alleges that the subject-to-appropriation bonds specified in HB331 are in violation of the state constitution regarding state debt and financing.

- The Superior Court granted the State's motion to dismiss on January 2, 2019. The State has moved for entry of final judgment. The plaintiff appealed the case to the Alaska Supreme Court on February 21, 2019. As such, it is unlikely that the suit will be resolved before the beginning of FY2020.

- The Spring 2019 Forecast assumes statutory appropriation for FY2020 and full credit payoff in FY2021 -this is an assumption for forecast purposes only.

Co-Chair Stedman wondered whether current litigation could affect the repackaging of bonds for redistribution. He

queried how the amounts and types of expenditures would be tracked in the revenue source book.

Commissioner Tangeman stated that it was a work in progress. He addressed the third bullet on Slide 21, which was related to the litigation. He addressed Co-Chair Stedman's question whether other state entities could bond for the financing; nothing had been decided because nothing had solidified, but if it was going to another state entity it would move from one balance sheet to another. He assured the committee that if a change were made it would be clear to the committee and hearing would be held to ensure that everyone agreed with the process.

Co-Chair Stedman was not concerned whether people agreed or disagreed, he stressed that any action taken by the committee needed to be recognized in the financial documents presented to the legislature. He hoped that any action taken would be easily recognizable as a change on the balance sheet. He stressed that substantial payments and impacts would result from decisions made at the committee table.

[10:07:10 AM](#)

Senator Hoffman asked for an explanation of the plaintiffs in the case and the basis for the legal argument.

Commissioner Tangeman stated there was a single plaintiff with an argument based on subject to appropriation claims, or the idea that one legislature should not financially bind future legislatures. He said that under the scenario, the balance of the debt that the state owed would be bonded for and then paid of through debt service over a few years. He said that the plaintiff believed that the bonds were not legal because of the subject to appropriations issue.

[10:08:12 AM](#)

Senator Micciche asked about the reason for dumping the remaining credit on to FY2021. He wondered why the amount wasn't staggered through a different schedule.

Commissioner Tangeman anticipated a favorable outcome at the supreme court level, which would allow the department to clear the debt from the books through the bonding process.

Co-Chair Stedman asked Commissioner Tangeman to remind committee members how the bonds were dealt with in the forecast for FY2020.

Commissioner Tangeman stated that there would be debt service shown to pay off the amount.

Co-Chair Stedman asked about the structure of the debts for FY2019 and FY2020.

Commissioner Tangeman stated that the spring forecast showed the \$100 million appropriated for FY2019 and \$184 million for FY2020, which was the statutory calculation.

[10:10:08 AM](#)

Co-Chair von Imhof looked at Page 13 of the Spring 2019 Revenue Forecast, which showed credits payed by the state and per-barrel credits. She observed that the total statewide production tax credits for FY2020 was projected at \$1.4 billion. She noted that Slide 20 showed about \$600 million in outstanding credits for repurchase, and she wondered whether the figure was also shown on page 13.

Mr. Stickel informed that Slide 20 and Slide 21 showed slightly different views of the tax credits. He said that Slide 20 showed what the ending balance and repurchasing amount would be if the legislature were to make the statutory appropriation for every year under the forecast. In that scenario the state would pay a little over \$100 million every year, and the final amount of repurchasable credits would be retired in 2024. The Spring 2019 Revenue Forecast used a different convention that assumed that the statutory appropriation was made for FY2019 and FY2020, and then the entire amount of outstanding credits was repurchased in FY 2021, rather than being spread across the 4-year time horizon.

[10:11:48 AM](#)

Senator Micciche thought that the purpose of a bond was to spread the repayment over time, but that the slide showed the payments being made in one lump.

Mr. Stickel explained if the bonding was made for the outstanding balance of credits, from a revenue standpoint that retires the outstanding credit balance, and the

payments on the bond are shown in the budget documents but not the revenue forecast.

[10:12:42 AM](#)

Senator Hoffman recalled passage of HB 331, which authorized issuance of up to \$1 billion in bond sales. He asked whether the number would be the amount owed in FY2018, would the \$180 million be returned to the state and the bonds sold accordingly, or was there an assumption that the bonds would be sold after FY2020 for the lower amount of \$600 million.

Commissioner Tangeman admitted that he did not know the answer. He thought that Senator Hoffman was asking if the state bonded for the full amount, come next spring, would the state have already spent down the appropriation if the legislature chose to appropriate the \$180 million.

Senator Hoffman asked if the state was going to be reimbursed for the dollars from the bond sale or was the administration going to sell the bonds at a lower price. He felt that following the intent of HB 331 would be advantageous given the state's fiscal climate.

Commissioner Tangeman thought that the department should entertain a discussion on the topic.

Co-Chair Stedman said that there should either be a reimbursement or a decrease in the bond amount, he warned against adding more debt.

Commissioner Tangeman clarified that the department would only bond for the balance that was due and not for an additional amount.

[10:15:16 AM](#)

Ms. Glover discussed the presentation "2013 Oil & Gas Production Tax Audit Update" (copy on file).

Co-Chair Stedman asked for Ms. Glover to offer a brief history of oil and gas production audits.

Ms. Glover recounted that the department was working through the 2013 tax year. In the past there had been a

substantial backlog. For the past year, the audit team had been focused on working on the 2012 and 2013 tax years.

Co-Chair Stedman interjected that in 2006 the state had gone from a gross tax to a net tax. He discussed the differences. He related that most expenditures were not questioned on tax returns; however, there was occasional differences of opinion on what items should be deducted. He said that a review of the net tax was conducted every year and the frequency of change in the state's tax regime had led to difficulty in keeping up with regulation and audits. He noted that the state's tax structure was one of the most complex in the world, with a six year statute of limitation for audits. He stressed that the concern at the table was twofold: what was the status of the audits and how quickly was the state approaching the statute of limitation.

[10:19:27 AM](#)

Co-Chair Stedman continued his remarks. He noted that the subject was being discussed in subcommittee. He said that the commissioner had been tasked to give an update on the audits.

[10:20:59 AM](#)

Ms. Glover referenced Slide 2, "Oil & Gas Production (OGP) Tax Audit Update":

- 2012 Audits Complete:
 - Reviewed all sections of a taxpayer's return
 - Some sections were 100% audited
 - Time consuming, but deemed to be necessary with new tax and new staff
 - Scope was wide and materiality was low -it was a learning process

- Stable tax law provides time to get caught up, plan, and develop better procedures.

- Tax Revenue Management System (TRMS) in place provides better transparency and organization of data.

Ms. Glover noted that progressivity had complicated past audits and the department had lacked the technological tools necessary for the work. She shared that after 2013,

the tax regime was stable and would make audits easier to execute.

[10:22:47 AM](#)

Ms. Glover showed Slide 3, "OGP Tax Audit Update":

- 2013 Audits:
 - Mostly complete
 - Several in review cycle. Many levels of review: peer, audit master, supervisor and director.
 - Similar scope as 2012 Audits. They were worked together in the early stages.

- Stop, Evaluate and Plan
 - Focused on improving the audit process starting with the 2014 Audits.
 - Held all-day meeting last week to brainstorm audit guidelines, timelines and strategy.
 - Plan to hold taxpayer engagement meetings before we kick off the 2014 Audit

Ms. Glover said that sessions were already planned to improve communication with taxpayers about issues and risks. She noted that 2014 was a minimum taxpayer year, which meant that not much time would be spent on lease expenditures, as that would likely not be a factor in the ultimate tax owed. She stressed that the department was working to be thoughtful in planning to execute an improvement plan.

[10:24:07 AM](#)

Co-Chair Stedman asked whether the work was "busy work" or would it result substantial audit information. He wondered how much money would potentially be disputed over the years.

Commissioner Tangeman stated there was hundreds of millions of dollars that changed hands depending on the price of oil and the amount of production. He stated that significant amounts of dollars were being audited and paid by the taxpayers each year.

Co-Chair Stedman asked how the funds came into the treasury.

Commissioner Tangeman stated that monthly tax payments were made followed by a true-up payment at the end of the year. Tax returns were filed in the spring of the following year and then an audit was done. The payments, the true-up at the end of the year, and the tax return was filed in March, which began the waiting process because of the backlog.

Co-Chair Stedman understood that audits could lead to hundreds of millions of dollars in adjustments to the figures. He asked where the eventual funds were finally deposited.

Commissioner Tangeman informed that tax payments were deposited into the general fund.

[10:26:07 AM](#)

Senator Micciche wanted to clarify the phrase "taxpayers."

Commissioner Tangeman stated that the largest taxpayers had historically been Exxon, ConocoPhillips, British Petroleum; and now included Hilcorp, and several small companies.

[10:26:55 AM](#)

Senator Hoffman considered the audit backlogs and asked for an explanation of what the legislature had done to address the backlog.

Commissioner Tangeman responded that the biggest thing that the legislature had done to help was to put in place the revenue management system. He recounted that in 2011 and 2012 there was an appropriation to put a revenue management system in place. He believed the legislature had recognized the importance of the audit division, as well as the importance on this revenue stream to the state. He thought it had been a good working relationship between the executive branch and the legislature.

Co-Chair Stedman recalled there had been a \$35 million appropriation for the revenue management system.

Commissioner Tangeman replied in the affirmative.

Co-Chair Stedman thought that the money spent highlighted the significance of the issue.

[10:29:04 AM](#)

Senator Wilson considered the timelines of filing the taxes and the audits. He wondered about the efforts being made when working with industry to clarify regulations in order to improve timeliness.

Commissioner Tangeman stated that the department had been working with the private sector to examine regulations and deregulate, or "clean up" regulations, deleting those that were not longer needed.

[10:30:34 AM](#)

Senator Wielechowski praised the auditing management system. He wondered about risk of missing out on auditing spring of 2013 due to the statute of limitations.

Co-Chair Stedman thought the question could be addressed further in the presentation.

[10:31:43 AM](#)

Ms. Glover displayed Slide 4, "OGP Tax Audit Update":

- Future Audits -Time and Backlog:
 - 2014 audits complete by 2nd quarter of 2020
 - 2015-2017 audits complete by 3rd quarter 2021
 - 2018-2019 audits complete by end of 2022
 - Maintain 3-year audit cycle on go-forward basis
- Continuous Improvement
 - Collaborative engagement with all taxpayers
 - Soliciting and incorporating taxpayer feedback into TRMS
 - Standardization of work-papers
 - Incorporating lessons learned from prior audits into the process

Ms. Glover stated that the 6-years began the date the tax return was filed. The returns were due at the end of March the following year, the 2013 tax returns were due March 31, 2014, the 6-year limitation would not be until March 2020. She stated that there was a plan to work the backlog down. She thought the department was confident that the statutory cut-off was not at risk for the 2013 returns. She spoke to the timeline for future audits. She said that the

department was confident that there were resources and staff to meet and maintain the 3-year audit into the future.

Ms. Glover clarified that when a taxpayer filed a monthly return, the estimated payment would go to the GF. If the assessment after audit resulted in additional taxes being owed, that amount would go to the CBR if won and collected.

[10:35:20 AM](#)

Co-Chair Stedman noted that the reference to the years 2015-2017, the severance tax structure was calculated on a gross value and did not need to be itemized, which would speed up the audits.

Co-Chair Stedman noted that there had been an earlier question on settlements and reiterated concern that those funds should not go to the general fund. He noted that the legislature could move the funds to the CBR if it chose to do so, but the question was where the funds should automatically be deposited.

[10:37:08 AM](#)

Senator Micciche thought there was an important distinction between qualified capital and operating credits versus per barrel. He lamented that the public often lumped the credits together.

Co-Chair Stedman thought that the net cash flow analysis discussion on Friday would speak to Senator Micciche's concern.

[10:38:28 AM](#)

Senator Micciche spoke to production risk. He thought that other than short-term production blips, it did not seem like the downside risk was the same as in the past. He wondered why the risk had been averaged.

Commissioner Tangeman thought a detailed analysis should come from DNR. He felt that the risk factor grew the further out in time production was expected to come online because of inconstant variables.

Co-Chair Stedman discussed housekeeping.

ADJOURNMENT
10:41:01 AM

The meeting was adjourned at 10:41 a.m.