SENATE FINANCE COMMITTEE
January 28, 2021
9:03 a.m.

9:03:43 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Click Bishop, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lyman Hoffman
Senator Natasha von Imhof
Senator Bill Wielechowski
Senator David Wilson

MEMBERS ABSENT

Senator Donny Olson

PRESENT VIA TELECONFERENCE

Lucinda Mahoney, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue.

SUMMARY

^PRESENTATION: DOR - FALL 2020 REVENUE FORECAST

9:03:43 AM

Co-Chair Stedman commented that the committee would be hearing about the fall budget forecast, which provided the executive branch and the legislative branch with historical and short-term revenue projections. The information would be used in the upcoming budget process and was a standard review. He wanted to ensure that new members of the legislature and the public could follow the conversation and could see how the information was pertinent to the subject of the structural deficit. The presentation would concentrate on state revenue.

9:06:19 AM

LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE (present via teleconference), thanked the committee for the opportunity to share the revenue forecast, which was prepared during a time of great uncertainty. She noted that adjustments had been made to the Revenue Sources Book as the state transitioned from dependence upon oil revenue to dependence upon primarily investments. More information about investments had been put in the book, including fiduciary duties, management fees, and investment risk volatility. She commented that the market was at an all-time high but had dropped the previous day. She commented on the volatility of the market. She noted that the Permanent Fund balance was just over $74 billion the previous day.

Commissioner Mahoney continued her remarks. She cautioned that Callan (as well as other Wall Street consultants) had forecast lower returns in the future. The economic research group had done its best to develop forecasts to provide the foundation for policy and decision making by the legislature. She pointed out that the forecast was independent, objective, and without political bias. She noted that the department would be providing two additional presentations the following Tuesday regarding cash management of the state's reserves, and the state's debt. The department had also prepared a presentation regarding the current oil production tax methodology and calculations.

9:09:32 AM

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE (present via teleconference), discussed the presentation "Fall 2020 Forecast Presentation" (copy on file).

Mr. Stickel addressed slide 2, "Agenda":

1. Forecast Background and Key Assumptions
2. Fall 2020 Revenue Forecast
    - Total State Revenue
    - Unrestricted Revenue

3. Petroleum Forecast Assumptions Detail
    - Oil Price

- Oil Production
- Oil and Gas Lease Expenditures
- Oil and Gas Credits

Mr. Stickel showed slide 3, "Forecast Background and Key Assumptions."

Mr. Stickel referenced slide 4, "Background: The Revenue Sources Book":

1. Historical, current, and estimated future state revenue
2. Discussion and information about major revenue sources
3. Prepared in accordance with AS 37.07.060 (b)(4), and supports long term plan under AS 37.07.020
4. Official revenue forecast used for Governor's budget proposal; updated in spring
5. Located at tax.alaska.gov

Mr. Stickel relayed that the department sometimes referred to the Revenue Sources Book as "the RSB." He noted that the RSB was an annual publication. He shared that the department gathered data from the tax revenue management system, the state accounting system, and state agencies to report actual revenue for the most recent year. The economic research group maintained models for each of the state's major revenue sources to generate a ten-year forecast for each source. In addition to the basic data, the RSB contained details about each of the state's revenue sources and key forecast variables. He reiterated that there had been some changes to the document, including reordering of chapters according to highest revenue magnitude to lowest. He discussed the topics of various chapters. There was also new information about investment revenue and its role in funding government services.

9:12:11 AM

Mr. Stickel turned to slide 5, "Key Alaska Economic Indicators":

1. Real State GDP: $50.9 billion in Q3 2020
   - Up 7.2% from Q2 2020, still down 4.9% from Q3 2019
2. Employment: 290,400 in December 2020

- Down 24,100 (-7.7%) compared to December 2019; heaviest impacts in leisure/hospitality, transportation/warehousing, and oil/gas industries

3. Wages & Salaries (seasonally adjusted): $21.8 billion in Q3 2020
   - Up 5.2% from Q2 2020 and flat from Q3 2019
4. Alaska Bankruptcies: 313 for calendar year 2020
   - Compared to 400 for all of 2019
5. Foreclosures: 98 in Q3 2020, 303 for all of 2020 so far
   - Compared to 197 in Q3 2019 and 729 for all of 2019
6. Housing Starts: 1,325 so far in 2020 (through November)
   - Compared to 1,540 through November 2019 and 1,692 for all of 2019

Note: Quarters on this slide are based on Calendar Year, i.e., Q1 = Jan-Mar, etc.
Sources: Federal Reserve, "Total Real Gross Domestic Product by Industry for Alaska, Millions of Chained 2012 Dollars, Quarterly, Seasonally Adjusted Annual Rate," Federal Reserve, "Total Wages and Salaries in Alaska, Thousands of Dollars, Quarterly, Seasonally Adjusted Annual Rate" (divided by 4), Alaska Department of Labor and Workforce Development "Research and Analysis Section," American Bankruptcy Institute "Filings by State and Jurisdiction," Alaska Department of Labor "Alaska Foreclosures," Federal Reserve "New Private Housing Units Authorized by Building Permits for Alaska, Units, Monthly, Seasonally Adjusted"

Mr. Stickel expressed that it was important to consider the state economy in addition to state revenue. He spoke to foreclosures as listed on the slide and explained that foreclosures being lower was likely due to various government programs that provided temporary aid and put limits on foreclosures. He noted that the state had likely not seen the full impact of COVID-19 and the recession on housing and foreclosures. He explained that the recent federal stimulus package had provided some additional support.

Senator von Imhof thought Mr. Stickel was correct in that despite unemployment being down, bankruptcies and foreclosures were also down. She agreed that federal funds from the Coronavirus Aid, Relief, and Economic Security (CARES) Act helped to keep people in their homes. She had learned that banks reported an increase in deposits by more than 20 percent, which she thought indicated people were holding onto cash and waiting. She thought the committee should consider the fact that there was a lot of cash sitting idle in the economy.

Senator Wilson asked about foreclosures and asked if there was an estimate on how the rate might go up when the moratorium was lifted at the end of the month.

Mr. Stickel did not have forecast for foreclosures. He thought there could potentially be a negative impact on bankruptcies and foreclosures, and acknowledged it was an area of uncertainty.

9:16:57 AM

Mr. Stickel considered slide 6, "Fall Forecast Assumptions":

- The economic impacts of COVID-19 are uncertain; DOR has developed a plausible scenario to forecast these impacts.
- Key Assumptions:
    - o Investments: Stable growth in investment markets, 6.75% Permanent Fund returns.
    - o Federal: Some CARES Act funds shown in FY 2021, no additional stimulus in FY 2022+.
    - o Petroleum: Alaska North Slope oil price of $45.32 per barrel for FY 2021 and $48.00 per barrel for FY 2022. No further oil production curtailments.
    - o Non-Petroleum: Most economic activity will return to baseline levels by FY 2022, except tourism full recovery by summer 2023.

Mr. Stickel stated that the Covid-19-related recession had affected every aspect of state revenue. He referenced Senator von Imhof's remarks about people holding onto cash, which he thought was an example of the tremendous level of uncertainty around the situation. He cautioned that while there was always a level of uncertainty with the forecast, the uncertainty was particularly large in the current time.

Mr. Stickel continued to address the slide. He noted that the forecast had assumed a 50 percent capacity tourism season for 2021, a 75 percent capacity season for 2022, and back to normal for 2023 and beyond. He qualified that "normal" signified numbers akin to 2019 levels, which saw a little over one million cruise ship passengers.

Co-Chair Stedman asked for Mr. Stickel to update the information regarding major cruise ship participants. He thought the cruise industry was updating schedules.

9:19:51 AM

Senator von Imhof thought it was hard to determine the economic impacts of COVID-19. She had gleaned that when travel fully opened and labor was in full force, there would be a significant pent-up demand. She thought the Gross Domestic Product would grow higher than three to four percent. She referenced the Spanish Influenza epidemic of 1920, which she precipitated the "roaring twenties" economy boom. She was observing many of the same behaviors and indicators. She thought there would be a tightening of oil supply as oil production decreased due to the new presidential administration. She thought there was potential for some significant growth in the state. She asked if Mr. Stickel was seeing some of the same indicators she mentioned.

Mr. Stickel emphasized the amount of uncertainty around the forecast. He affirmed that there was absolutely opportunity for revenue to be higher than expected, however the opposite was also true. He relayed that the department's approach was to highlight the uncertainty when discussing the forecast. He echoed the point of Co-Chair Stedman about updating the forecast regularly.

9:22:46 AM

Co-Chair Bishop asked Mr. Stickel to look into an update from the air travel industry. He thought there were new carriers coming to the state and he wondered about anticipated growth.

Mr. Stickel stated he would reach out to the airline association as part of the spring forecast process. He reiterated that he would take another look at tourism assumptions and would reach out to industry while preparing the spring forecast.

Senator Hoffman did not see any bullet points referencing the governor's decision with regard to Permanent Fund Dividends (PFDs) or his early CARES Act payments. He asked if the items would affect the economy of the state in any way.

Mr. Stickel stated that the goal of the presentation was to lay out the revenue forecast under the status quo, without any proposed legislative changes. He thought that the Office of Management and Budget (OMB) would present the governor's proposed budget the following day.

Co-Chair Stedman affirmed that OMB would be presenting the following day and Senator Hoffman could pose his question.

Co-Chair Stedman shared that the expectation of committee members was to get through the operating budget in the first or second week of March. He thought the legislature might need the spring forecast numbers earlier than normal. He thought it would beneficial if DOR kept the timing in mind as the committee worked through the budget process.

9:25:46 AM

Mr. Stickel displayed slide 7, "Relative Contributions to Total State Revenue: FY 2020," which showed a graphical representation of the various sources of state revenue. He commented that the graphic showed the relative importance of the different revenue sources to total state revenue. He pointed out that federal revenue, investment earnings, and oil and gas were the biggest sources of state revenue, respectively. While other revenue sources made contributions to state revenue, the top three were significantly higher. All other revenue sources outside federal investment and petroleum amounted to a little over 12 percent of total revenue in FY 20.

Senator von Imhof asked if the federal revenue included the $5.4 billion in federal CARES Act funds that came to the state.

Mr. Stickel noted that FY 20 federal revenue included a portion of the CARES Act money. Some of the funds flowed directly to the state, and the money was reflected in FY 20 and FY 21. Some of the CARES Act fund did not flow through state government.

Co-Chair Stedman asked for a rundown on investment earnings and how the state was dealing with the Permanent Fund's 5 percent payout. He asked if the percentage of petroleum revenues listed was net of all offsets due to any credit payments.

Mr. Stickel noted that there were upcoming slides that might be helpful. He detailed that slide 7 showed total state revenue, including both realized and unrealized earnings of the Permanent Fund regardless of if the funds were used for dividends, government spending, or retained in the fund. Petroleum revenue and total state revenue included all revenue net of tax credits that were applied in calculation of tax liability.

Co-Chair Stedman asked about investment earnings and asked if the earnings would be zero or negative if the market was declining. He asked if Mr. Stickel was not using the 5 percent payout, but rather the actual market returns in the fiscal year.

Mr. Stickel answered in the affirmative and thought there was additional information on slide 9 would further address Co-Chair Stedman's question.

Co-Chair Stedman thought some of the concepts might need to be restated. He emphasized that market returns would not be indicative of what was being considered at the table. The committee would consider the five-year average of the Permanent Fund with the 5 percent payout. He thought the numbers could be vastly different.

9:29:28 AM

Mr. Stickel showed slide 8, "Fall 2020 Revenue Forecast."

Mr. Stickel looked at slide 9, "Total Revenue Forecast: FY 2020 to FY 2022 Totals and Percent Change from FY 2020," which showed a table with total state revenue from all sources for FY 20 and forecast for FY 21 and FY 22. He clarified that the slide put the graphic from the previous slide in numeric form. Total revenue included four different sources: investments, federal receipts, petroleum, and other non-petroleum revenues. In the revenue forecast and budget, revenues were broken into four categories of restriction. Unrestricted General Funds (UGF) were revenues that could be appropriated for any purpose and were the focus of most budget discussions.

Mr. Stickel explained that Designated General Funds (DGF) were technically available for appropriation but customarily used for a specific purpose. He used the example of alcohol tax revenue to illustrate Designated General Funds (DGF), half of which was customarily appropriated to the Alcohol and Other Drug Abuse Treatment and Prevention Fund. Other restricted funds had dedicated uses and generally were truly not available for appropriation. He used the example of royalty revenue to the Permanent Fund and School Fund, and motor fuel tax revenue from aviation that was federally required to be used for specific purposes. All federal revenue had to be used for specific purposes and was considered restricted revenue.

Mr. Stickel continued to speak to slide 8. For FY 20, total state revenue from all sources was about $8.7 billion. For FY 21 the total was forecast at $10.9 billion, and $10.3 billion for FY 22. The UGF portion of the total was $4.5 million in FY 20, and $4.3 billion was forecast for both FY 21 and FY 22. He directed attention to the two columns on the far right of the table, which showed the percent of change between FY 20 and FY 22 as well as the change between FY 21 and FY 22. Overall, the FY 22 forecast for UGF was 5.8 percent lower than FY 20, and 1.4 percent lower than FY 21. The total state revenue was 19 percent higher in FY 22 and 5 percent lower than FY 21 forecast.

Co-Chair Stedman asked for greater clarification on slides when dealing with the investment revenue. He thought the size of the Permanent Fund could distort numbers. He noted that the committee would be concentrating on the 5 percent payout with a five-year lookback for smoothing for the budget process, rather than the expectation of one-year gains or losses.

9:33:32 AM

Senator von Imhof thought when investment revenue was under UGF, it would be nice to label the funds as the 5 percent payout. She thought it would be nice to indicate the amount of the PFD payout. She thought it was important for the public to know. She asked about the blue bar showing the history of FY 20 revenue and asked about if "Investment Revenue" under the Other Restricted Revenue category, which showed a negative $1.2 billion.

Mr. Stickel stated that for the PFD, the percent of market value (POMV) draw was counted, and any residual balance of the Permanent Fund was counted as "Other Restricted Revenue." In FY 20, the POMV took a little more out of the fund than the total earnings of the fund for the year. Going forward, the opposite was forecast.

Co-Chair Stedman thought it was important to work on clarity around the topic so that committee members and the public clearly understood. He stated that members would be focusing on the cash flow and what was available for appropriations following the guidelines. he thought the public and the vast majority of the legislature would struggle to understand the chart on slide 9.

Senator Hoffman referenced the Petroleum Revenue listed on the chart under "Other Restricted Revenues," and asked about the drastic 57.5 percent reduction from FY 20 to FY 022.

Mr. Stickel stated that the Other Restricted Petroleum Revenue consisted of two components. One component was the Constitutional portion of royalties that were deposited to the Permanent Fund and School Fund. The other component was tax and royalty settlement deposited to the Constitutional Budget Reserve (CBR). Both of the amounts were expected to be lower in FY 21 and FY 22 compared to FY 20.

Co-Chair Stedman stated his staff would work with Mr. Stickel to have the information on slide 9 reworked in a new format in order to be clearly delineated.

9:37:42 AM

Mr. Stickel addressed slide 10, "Unrestricted Revenue Forecast: FY 2020 to FY 2022 Totals," which showed a table. He specified that investment revenue was the largest source of unrestricted revenue to the state. Investment revenue contributed nearly $3 billion in FY 20 and was estimated to contribute $3.1 billion of unrestricted revenue in FY 21 and FY 22. The main element of the revenue was the POMV transfer from the Permanent Fund, which began in FY 19.

Petroleum generated about $1.1 billion of UGF revenue in FY 20 and was forecast to contribute a little under $1 billion in each of the two next fiscal years. Lastly, non-petroleum sources were expected to contribute a little under $400 million of unrestricted revenue in each of the next two years. He shared that the next few slides would walk through each of the revenue sources in more detail.

Co-Chair Stedman asked Mr. Stickel to keep in mind that the committee was curious about items such as the $861.7 million from FY 21, and whether it was net cash on the table or if was before the dilution of any offsets. He asked Mr. Stickel to review the details of funds as he went through the presentation.

Mr. Stickel advanced to slide 11, "Unrestricted Revenue Forecast: FY 2020 and Changes to Two-Year Outlook." The slide summarized some of the key changes to the unrestricted revenue forecast between the spring 2020 forecast released in April and the current fall 2020 forecast. He highlighted the Alaska North Slope (ANS) oil price had increased by $8.32/bbl for FY 21 to $45.32/bbl. The price increased by $7/bbl for FY 22 to $48/bbl. The reason for the increase was some recovery and stabilization in the oil market as it worked through COVID-related issues. He shared that the price was actually currently higher than the forecast being discussed.

Mr. Stickel continued to address slide 11. There was no change to the FY 21 forecast for the Permanent Fund transfer, but the FY 22 estimate was increased by $21 million due to stronger than expected market returns to the end of FY 21. He added that FY 21 was the last year in the calculation of the five-hear average for the FY 22 transfer. For total unrestricted revenue, FY 20 was close to expectations, while the FY 21 the forecast was increased by $87.5 million primarily due to the higher oil price forecast. For FY 22, the forecast was decreased by nearly $60 million, even with the higher oil price assumption. The biggest contributor to the change was some reductions to the corporate income tax forecast, which he would address in greater detail later in the presentation.

9:41:11 AM

Mr. Stickel looked at slide 12, "Unrestricted Investment Revenue: FY 2020 to FY 2022 Totals," which showed a table providing more detail on unrestricted revenue. He reiterated that investments were now the state's largest source of unrestricted revenue and the Permanent Fund transfer alone was expected to account for at least two-thirds of unrestricted revenue every year going forward. He thought the ratio spoke the importance of the Permanent Fund and the realty of living with low oil price and oil production. The Permanent Fund transfer contributed $2.9 billion in FY 20 and was estimated to contribute $3.1 billion in FY 21 and FY 22. In addition, there was a small amount of other unrestricted investment revenue which represented primarily earnings on cash balances of the General Fund.

Mr. Stickel showed slide 13, "Unrestricted Investment Revenue: Percent of Market Value (POMV) Transfer Forecast," which also showed a line graph entitled 'POMV Transfer Forecast':

- The statutory POMV rate changes to 5% beginning FY 2022.
- For FY 2019 - FY 2021 this rate was 5.25%.
- Forecast assumes Permanent
Fund's long-term total return expectation of 6.75%.
- Differing Permanent Fund returns and petroleum deposits could significantly alter actual POMV

Mr. Stickel stated that the slide showed the estimated transfer from the Permanent Fund to the General Fund for FY 20 and each year for the next ten years. The transfer was estimated to be over $3 billion each year, growing to $3.7 billion by FY 2030. The forecast was based on an assumption of a 6.75 percent annual return for the fund, and a 5 percent of market value calculation. The Permanent Fund transfer was a fairly stable revenue source due to how it was calculated. the annual transfer was based on the average market value for the first five of the last six fiscal years, which removed a lot of the impacts of market volatility. He reiterated that the slide showed a baseline forecast and did not incorporate any additional draws on the Permanent Fund beyond the POMV calculation.

Co-Chair Stedman stated that the projected rate of return might need to be updated, as well as the impact ad hoc draws or any other issues that affected the management style of the fund and the probability of a predictable cash flow.

Senator von Imhof thought there should be alternatives shown. She pondered different amounts of draws based on different scenarios and the governor's proposed budget and bills. She asked if Co-Chair Stedman thought there should be various colored lines on the chart to depict different scenarios.

Co-Chair Stedman thought that it would be better to wait until proposals were being considered, and the committee could run scenarios, including the effect of lowering the payout. He anticipated a full review of the options and the ability for members to make their own political interpretation and position. He thought it was important for the members and public to know what decisions were being made.

Co-Chair Bishop commented that the committee would get to the discussion, but he thought it was imperative that the state not overdraw. He referenced a comment by Co-Chair Stedman that the state "had to make payroll."

9:45:45 AM

Mr. Stickel referenced slide 14, "Unrestricted Petroleum Revenue: FY 2020 to FY 2022 Totals," which showed a data table. He highlighted that there were four main sources of unrestricted petroleum: property tax, corporate income tax, production tax, and state royalties. The state levied a property tax on all oil and gas property in the state, which was a fairly stable revenue source that generated a little over $100 million per year. He noted that the table only showed the state's share of the property tax, and not the over $400 million generated for municipalities. He discussed corporate income tax on profits. The previous year had been difficult, and the tax had generated zero revenue. The department forecast only $5 million for FY 21 and $20 million for FY 22.

Mr. Stickle discussed the oil and gas production tax, the state's severance tax on petroleum. For North Slope production there was a net profits tax with a gross minimum tax floor. At current prices, the state was in the minimum tax regime throughout the forecast. The production tax was expected to bring in a little under $200 million per year for the next two years, which was revenue after accounting for deductions and credits applied against tax liability.

Mr. Stickel continued that royalties for oil and gas production on state land was the largest source of unrestricted petroleum revenue, bringing in $675 million in FY 20 and forecast at between $500 and $600 million in the following two years. He noted that the amounts did not show all royalties, but just the unrestricted share. In addition to the amount shown on the slide, a portion of the royalty revenue was deposited into the Permanent Fund and the School Fund. Later in the presentation he would address they key assumptions driving the petroleum revenue forecast, including price, production, and company investment.

Co-Chair Stedman asked about Mr. Stickel's comment about going into more detail about the petroleum revenue forecast.

Mr. Stickel affirmed that the last section of the presentation was a detailed discussion of the various assumptions behind the petroleum revenue forecast.

Co-Chair Stedman stated he would hold his questions until the discussion. He asked if Mr. Stickel could highlight the negative expectation of corporate income tax for FY 22. He thought pricing had been advanced a bit, and volume might be up a bit. He asked why there was a negative projection for corporate income tax, versus the debacle in FY 20 when there was zero.

Mr. Stickel informed that slide 16 and slide 17 would specifically address the corporate income tax forecasts.

Co-Chair Stedman agreed to hold his question until slide 16.

Senator Hoffman had the same question as Co-Chair Stedman.

9:49:01 AM

Mr. Stickel turned to slide 15, "Unrestricted Non-Petroleum Revenue: FY 2020 to FY 2022 Totals," which had a data table. The largest component of the unrestricted non-petroleum revenue was taxes. Typically, corporate income tax was the largest source, and it had generated $100 million in FY 20. The forecast was only $30 million for FY 21 and $25 million for FY 22. The following two slides would go into greater detail on corporate income tax. Other significant taxes include the mining license tax, the insurance premium tax, fisheries taxes, and excise taxes. In total, non-petroleum taxes were forecast to generate $215 million in FY 21, and $228 million in FY 22. Other than taxes, other non-petroleum revenues include a variety of licenses and permits, charges for services, fines and forfeitures, non-petroleum rents and royalties, and miscellaneous revenues like dividends from state corporations. The total non-petroleum unrestricted revenue was expected to be $363 million in FY 21, and $373 million in FY 22.

Senator von Imhof asked if the decrease in many of the taxes was not necessarily due to a change in tax rates but due to less in economic activity. She mentioned fisheries taxes. She asked what Mr. Stickel about the cause of the decrease.

Mr. Stickel stated that the impacts of the COVID-related recession were incorporated into the revenue forecast. The expectation of lower economic activity and value had impacted some sources such as fisheries taxes. More significant impacts were forecast for tourism-related taxes. The information was reflected in the drop from FY 20 to FY 21. He thought the decrease in tobacco taxes had to do with the declining use of cigarettes.

Co-Chair Stedman thought it was apparent that there was increasing mining taxes and marijuana taxes.

9:52:11 AM

Mr. Stickel considered slide 16, "Unrestricted Revenue Forecast: Non-Oil & Gas Corporate Income Tax (CIT)," which showed a bar graph entitled 'Non-Oil & Gas CIT Collections." He noted that one of the major changes in the fall revenue forecast had to do with corporate income taxes, which was a major area of focus for the forecast research group. The group had built a model that analyzed top taxpayers in each industry, that attempted to project company profitability and tax payments over the next several years. There were two major unusual impacts that were considered in the forecast: the significant recession and impacts from the CARES Act. One provision of the CARES Act allowed corporations to carry back net operating losses (NOL) from tax years 2018, 2019, and 2020 up to five years back to receive relief funds for taxes paid.

Mr. Stickel continued to speak to the effects of the CARES Act on corporate income tax. There was another provision in the CARES Act that allowed companies to accelerate certain alternative minimum tax refunds into tax year 2019. The state adopted the federal tax code by reference, so the CARES Act provisions were automatically applied to Alaska's tax, unless the legislature chose to de-couple or modify the provisions.

Mr. Stickel relayed that there was an expectation of lower revenue in FY 21 for general corporate income tax based on the weak economy. The CARES Act impacts further reduced the FY 21 revenue by another $20 million. For FY 21, the impacts were based on the CARES Act-related relief funds for tax years 2018 and 2019. For FY 22, he estimated $72 million in CARES Act related refunds, bringing the net revenue to $25 million. The biggest refunds were expected for tourism-related companies, which were expected to show huge losses for tax year 2020. For FY 23, the department forecast that general corporate income tax revenue rebound to $130 million, based on an assumption of economic recovery.

Co-Chair Stedman asked if the department would be bringing forward legislation to uncouple the state income tax with federal income tax. He asked if the department considered the coupling as fair and equitable and needing to be maintained.

Commissioner Mahoney stated that the department had been evaluating uncoupling with federal code and was open to discussing options with the legislature regarding the impact. She thought it was important to take the impact to the state's revenues into consideration. She reiterated that the tourism industry was hard-hit, and the funding provided a small cushion.

Co-Chair Stedman asked for the administration to inform the legislature if it had a position on the matter. He added that the legislature had not given the matter much thought or discussion.

9:56:10 AM

Mr. Stickel displayed slide 17, "Unrestricted Revenue Forecast: Oil & Gas Corporate Income Tax (CIT)," which showed a bar graph entitled 'Oil and Gas CIT Collections.' The slide presented a similar chart to previous slides but for oil and gas corporate income tax. He referenced Senator Hoffman's question and commented that the oil and gas industry was especially impacted by Covid-19 and paid essentially no corporate income tax for FY 20. The department forecast very low revenue for FY 21, even before the CARES Act impacts. After the impacts, the department expected only $5million for FY 21 oil and gas corporate income tax. For FY 22, there was an estimated $63 million of CARES Act related refunds, bringing the net revenue to a negative $20 million. The numbers were based on anticipated CARES Act-related refunds for tax year 2020 losses. Oil and gas corporate tax revenue was estimated to be $55 million for FY 23, which was far lower than the several hundred million per year in the last decade.

Senator von Imhof did not fully understand the calculation of how the CARES Act cash flow was affecting corporate income tax.

Mr. Stickel explained that prior to the CARES Act, if a company incurred a NOL in a given year, it could carry the loss forward and potentially reduce corporate income tax payments in future years. The CARES Act allowed a company with a NOL in a given tax ear, for tax years 2018 - 2020, the company could carry any loss back and restate tax returns to obtain refunds for previous taxes paid. The yellow bar on slide 17 showed the estimation of oil and gas corporate income tax based on payments expected during the fiscal year for activity during the fiscal year. The blue bar adjusted for expected CARES Act-related refunds. The difference between the two bars in FY 21 would be expected refunds for 2018 and 2019 losses that were carried back up to five years. In FY 22, some companies were expected to have lost significant amounts of money in 2020, and the 2020 loss could be carried back five years.

9:59:48 AM

Co-Chair Stedman asked when the execution of the refund would impact the treasury.

Mr. Stickel stated that some companies had already filed returns for FY 18 and FY 19 refunds. He expected to pay the refunds in the remainder of FY 21. The refunds for FY 20 were due in April, or due in November with an extension. He anticipated that refunds for any 2020 losses would be paid out of FY 22.

Co-Chair Stedman asked if the department cut the check for the refunds or rather offset the amount against current tax implications.

Mr. Stickel stated that companies requesting a refund could request a check or choose to offset the refund against future tax liability. Given the magnitude of the payments, the forecast expected sending the money by wire.

Senator von Imhof asked Mr. Stickel to provide a breakdown of how much the state expected to be paying out for tax refunds over the next three or four years.

Mr. Stickel stated that the expected refunds specific to the CARES Act would be the difference between the yellow and blue bar. For FY 22, he estimated $63 million of CARES Act refunds.

Co-Chair Stedman thought the committee could request the information be included in future discussions about the state's cash position so that the impact of the CARES Act could be clearly understood.

Senator von Imhof did not think the information was clear.

10:03:23 AM

Co-Chair Bishop had the same question as Senator von Imhof. He thought the refund amounts should be clearly stated on the slide.

Senator Hoffman thought the slide showed the effectiveness of the oil and gas lobby and how the lobby's impact on a national level effected the state. He asked if the department was monitoring the next big federal stimulus package being contemplated, and if the same provision would apply to Alaska.

Mr. Stickel stated that the ability to carry back a NOL for corporate income tax purposes was built into the forecast and assumed the law would remain the same at the federal level. He affirmed that the department was following the discussion regarding the potential upcoming federal stimulus package. He thought OMB was following the discussions the most closely. The department would be reviewing the developments and incorporating them into the spring forecast update. He was not anticipating any changes to the corporate income tax ability to carry back.

Co-Chair Stedman thought it was important to clearly delineate the information for future legislatures. He thought the corporate income tax figures were significant, and the details might not be clear. He stressed that he was not commenting on the policy, but rather the importance of clarity.

10:06:50 AM

Mr. Stickel showed slide 18, "Petroleum Forecast Assumptions Detail." He noted that the final slides would consider oil prices, oil production, and company spending.

Mr. Stickel looked at slide 19, "Petroleum Detail: Changes to Long-Term Price Forecast," which showed a line graph of oil prices. The slide showed the DOR Fall 2020 forecast compared to the DOR Spring 2020 forecast for ANS. He detailed that the oil price forecast was based on the most recent futures market projections. The fall forecast numbers were generated on December 1, 2020. Oil prices had stabilized over the last few months as demand recovered and markets worked through excess supply. The fall forecast included an average oil price for FY 21 of $45.32/bbl, an increase of $8.32 above the spring forecast. For FY 22, the oil price forecast was $48/bbl, an increase of $7 higher than the spring forecast. Beyond 2022, the department anticipated that oil prices would increase with inflation by a dollar or two per year. The forecast was based on a "lower for longer" paradigm going forward.

Co-Chair Stedman conveyed that the committee would ask Mr. Stickel to update the forecast in a couple of months. He hoped the legislature would be done in the middle of March.

Mr. Stickel addressed slide 20, "Petroleum Detail: Nominal Brent Forecasts Comparison as of 1/20/2021," with a chart that showed how the department's price forecast compared to other forecast sources. He explained that the state's Alaska North Slope (ANS) forecast was compared to Brent oil prices from the Energy Information Administration (EIA). He detailed that futures markets and average analyst forecasts were compared to Brent, which was an international benchmark crude that was typically priced similarly to Alaska crude oil. He noted that the forecast was still very close and within a dollar or two of the futures market and EIA forecast. He thought it was interesting that analysts on average expected slightly higher prices than the futures market or the state's forecast for FY 22 and beyond.

10:09:44 AM

Mr. Stickel advanced to slide 21, "Petroleum Detail: UGF Relative to Price per Barrel (without POMV): FY 2022," which showed a line graph that showed how UGF for FY 22 changed with different oil prices. He noted that the chart came from Appendix A of the RSB. He highlighted that for FY 22, there was a price of $48/bill, below which each dollar signified about $15 to $20 million of unrestricted revenue. Above the forecast price, each dollar of change equated to $20 million to $30 million of unrestricted revenue.

Co-Chair Stedman asked for assistance in understanding the tipping point to go into the net profits tax under the current price and volume scenario.

Mr. Stickel explained that Co-Chair Stedman was referencing provisions of the oil and gas production tax where a taxpayer for North Slope oil production paid a higher of a gross minimum tax or a net tax (after credit). The forecast oil price of $48/bbl was around the level at which some taxpayers started to pay above the minimum tax. The level at which a company went from the minimum tax floor to the net tax after credit depended upon each company's portfolio of operations and investment. The range extended from about $50/bbl to about $90/bbl. There was a steeper slope in the revenue curve when going above the forecast price.

Co-Chair Stedman thought Mr. Stickel was discussing consolidated data from multiple companies. He asked about the aggregate tip-over point.

Mr. Stickel stated he would be happy to calculate an aggregate number. He referenced the range shown on the slide that extended from $50/bbl to $90/bbl depending upon the company.

10:13:07 AM

Co-Chair Stedman referenced the gross tax and thought the well-head value was easy to calculate. He was curious about any offsets that would come against the amount. He wanted to know how the $5 per barrel credit was impacted. He asked about the Middle Earth and Small Producer credits.

Mr. Stickel stated that the department was developing a presentation that would walk through all the details of production tax calculation for delivery at a later date.

Co-Chair Stedman agreed to discuss his questions at a later date. He asked if Mr. Stickel was referring to the order of operations.

Mr. Stickel affirmed that the department was updating the presentation and would go into as much detail on production tax as the committee would like.

Co-Chair Stedman thought the corporate tax structure was an important topic. He thought it would be good for new members and staff to gain a basic understanding of the order of operations and complexities of the tax structure.

10:16:20 AM

Mr. Stickel looked at slide 22, "Petroleum Detail: North Slope Petroleum Production Forecast," which showed a line graph depicting the forecast for oil production on the North Slope for the next ten years. There was a high case and low case shown for the next ten years. In general, the production forecast showed a decline in FY 22 of 8 percent to 440,000 barrels per day. The decline was largely due to not doing much development drilling in 2020 due to low prices and the COVID-19 pandemic. For FY 23 and beyond, production was expected stabilize and increase slightly to reach 482,000 barrels per day by FY 30. The increase was based on an assumption that drilling resumed in existing fields and new fields cam online. He used the example of new fields including Greater Moose's Tooth 2, Pikka, and Willow. He explained that the official forecast shown on the graph was a "most likely" value taken from a range of possible outcomes. He commented on the uncertainty as shown in the high and low cases on the graph.

Mr. Stickel noted that there had been a question the previous day about differences in DOR versus the DNR forecast. There were two key differences in the numbers the departments produced. He explained that for the Revenue Sources Book, DOR took the DNR forecast and updated it with actual production figures that were available. Another difference was how natural gas liquids were accounted for. In its revenue forecast, DOR assumed that 10,000 barrels per day of natural gas liquid would be shipped from Prudhoe Bay to Kuparuk, to be used in a large-scale enhanced recovery project. The natural gas liquids were considered produced for royalty purposes and were included in production numbers from DNR. Conversely, for tax purposes, DOR did not consider the natural gas liquids produced until they flowed into the pipeline and the 10,000 bpd were not included in the forecast being presented.

Co-Chair Stedman asked Mr. Stickel to consider the political impact of the new presidential administration on the production forecast. He thought there was concern that the administration may try to hinder Willow and other projects, which could significantly hinder the state and its partners. He was very concerned about the restrictive policy directional change that could be forced upon the state.

10:20:00 AM

Senator Wielechowski asked what sort of tax deductions were allowed by the state on federal properties such as Willow and Pikka.

Mr. Stickel clarified that Pikka was on state land and Willow was located within the National Petroleum Reserve which was federal land. He noted that the same production tax applied to all production within the state regardless of the land type. He reiterated that the department would be bringing a presentation before the committee in the near future that would address deductions in greater detail.

Co-Chair Stedman asked Mr. Stickel to refresh everyone's memory about differences in oil credits, stimulus, or offsets. He considered differences due to ownership.

Senator Wielechowski asked about incumbent producers on federal lands such as Willow - he understood that the company could write the project off against any Prudhoe Bay, Kuparuk or Alpine taxes at a rate of about 35 percent.

Mr. Stickel stated that for an existing producer was investing in new production, the calculation for production tax was a slope-wide calculation. To achieve a 35 percent value for the investment, it would require quite high oil prices. He would address the nuances in the forthcoming presentation.

Co-Chair Stedman thought Senator Wielechowski was referencing the base tax versus the corporate income tax. He suggested Mr. Stickel consider ensuring clarity of the various tax levels for each corporation. He discussed write-offs for development expenditures. He thought the time frame affected the economics of the decision. He wanted the upcoming presentation to clear up some misconceptions.

10:24:25 AM

Senator von Imhof recalled the passage of SB 111 three years previously, which had established ring-fencing. The provision affected how various companies could apply or deduct certain expenses from one well to another well. She was sure Mr. Stickel and the department would address some of the provisions passed in SB 111 that still affected how taxes were being collected.

Co-Chair Stedman thought the forthcoming presentation would clear up some misconceptions about the oil and gas tax structure.

Mr. Stickel spoke to slide 23, "Petroleum Detail: Changes to North Slope Petroleum Production Forecast," which showed a line graph which compared the fall forecast to the spring 2020 forecast. He observed that the overall changes shown on the graph were fairly minor. He pointed out that the forecast had been reduced slightly for FY 21 and FY 22 based on lower levels of activity. The FY 22 reduction was 4 percent lower than the spring forecast. The FY 23 to FY 25 forecast had been increased partly due to the impact of delayed activity and revised expectations for new development. The long-term forecast was slightly lower than the spring forecast, but there was a lot of uncertainty in the out years as shown on the previous slide.

10:26:44 AM

Mr. Stickel referenced slide 24, "Petroleum Detail: North Slope Allowable Lease Expenditures," which showed a line graph that depicted how allowable lease expenditures had changed over the past decade along with a 10-year forecast. The data reflected costs of production reported on tax returns that were deducted in the net profit calculation in the production tax. Company spending was also an important measure of current and planned investment in Alaska.

Mr. Stickel cited that in FY 20, North Slope capital expenditures were $2.6 billion and operating expenditures were $2.9 billion, signifying the second year of increases but still below the middle of the last decade. For FY 21, there were dramatic cutbacks in spending, but there were some signs of recovery. He expected FY 21 total North Slope spending to be down by $1.6 billion from the prior year. Capital expenditures were forecast to increase in FY 22 and FY 23 as companies invested in major new developments while also resuming drilling major fields. In a longer term there was expected stabilization of a little over $2 billion per year in capital expenditures. Many of the reductions over the last year for operating expenditures were expected to be permanent as companies reduced costs. There was a small increase mid-decade with the addition of costs for new fields that would come online.

Senator Wielechowski understood that lease expenditures included those that happened on federal land. He asked how many of the expenditures took place on federal land.

Mr. Stickel did not have a breakdown of expenditures on federal versus state land at hand. He offered to provide the information at a later time. He affirmed that the amounts shown on slide 24 represented all allowable lease expenditures across the North Slope, which would include state, federal, and private land.

Co-Chair Stedman pondered whether the root of Senator Wielechowski's question was if there was allowable lease expenditure deduction, was there a severance tax to come against for the field.

Senator Wielechowski was trying to determine the impacts of the Biden Administration decisions. He was curious how many lease expenditure tax write-offs were being allowed on federal lands.

Co-Chair Stedman asked for Mr. Stickel provide the information to the committee. He asked if Mr. Stickel would include any information highlighting impact of potential changes by the Biden Administration.

10:30:38 AM

Mr. Stickel turned to slide 25, "Petroleum Detail: North Slope Transportation Costs," which showed a line graph depicting the changes in North Slope transportation costs per barrel over time. He detailed that the costs, also known as neck-back costs, reduced the value of oil for both tax and royalty purposes. The transportation costs included all costs of getting oil to market, including feeder pipeline tariffs, the Trans-Alaska Pipeline tariff, and anchor transportation costs. For FY 20, the average transportation cost for ANS oil was $8.15/bbl. The forecast was $9.21/bbl for FY 21, and $9.91 for FY 22, increasing to about $11/bbl by FY 30. The increases for the following two years were largely a function of lower oil production in the pipeline and further out the increases were a function of oil production, inflation, and a greater portion of production being subjected pipeline tariffs.

Co-Chair Stedman had noticed there had been a lot of notice within financial periodicals regarding lenders not wanting to lend to entities dealing with hydrocarbon extraction, particularly in Alaska. He wondered if the commissioner had any comment and how damaging the issue might be to the state's development prospects.

Commissioner Mahoney thought what was happening in the finance community regarding North Slope investment was extremely disappointing. She emphasized that the state operated the fields with extreme care for the environment, and she wondered if the message was widely communicated. She thought it was difficult to say how the situation would impact future investment, which was a function of return on investment and how a project would fit within a potential investor's portfolio. She thought that the state could work to impact or change the messaging to convey that the state was a very environmentally sound developer.

Co-Chair Stedman was concerned about final investment decisions about Willow and Pikka and did not want to have spent massive amounts of credit. He asked the department to get back to the committee with information about the two areas. He asked about the financial exposure the state might be facing if the Biden Administration blocked the projects. He asked for ideas as to how to help clear the outstanding cash credits the state owed. He referenced a bond package that did not go forward due to constitutional issues and was interested in hearing ideas about how to pay the tax credits.

10:36:06 AM

Commissioner Mahoney stated that the issue of tax credits was important to the department and to the governor. She stated the department was actively looking at two different proposals to pay down the liability quicker. She noted that the statutory payment was included in the FY 22 proposed budget to pay off the FY 22 component.

Co-Chair Stedman asked about the amount of the statutory payment in the budget.

Commissioner Mahoney thought the amount was $60 million.

Mr. Stickel thanked the committee for the opportunity to present. He looked forward to returning and discussing oil taxes in detail.

Co-Chair Stedman asked Mr. Stickel to work with the committee on updating some of the slides. He offered to work with the department on the order of operations information. He reiterated importance of the public understanding of the process and thought the tax structure was one of the most complicated in existence.

Co-Chair Stedman discussed the agenda for the following day. He shared that the committee was forming budget subcommittees.

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ADJOURNMENT

10:39:56 AM

The meeting was adjourned at 10:39 a.m.