Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version: HB 247
Fiscal Note Number:
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Identifier: HB247-DOR-TAX-2-1-16
Title: TAX;CREDITS;INTEREST;REFUNDS;O & G
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: Governor

Department: Department of Revenue
Appropriation: Taxation and Treasury
Allocation: Tax Division
OMB Component Number: 2476

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates				
OPERATING EXPENDITURES	**FY 2017**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Fund Source (Operating Only)

None							
Total	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues		100,000.0	100,000.0	50,000.0	50,000.0	50,000.0	50,000.0

Estimated SUPPLEMENTAL (FY2016) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 1,500.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? yes
If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/17

Why this fiscal note differs from previous version:

Revised to conform to the fiscal note that capitalizes the Oil and Gas Tax Credit Fund. That note includes adequate funds to transition from the existing program as the changes in this bill are implemented. Reductions to expenditures are removed from this note because they are contained in the Credit Fund note.

Prepared By: Ken Alper, Director Phone: (907)465-8221
Division: Tax Division Date: 02/01/2016 01:00 PM
Approved By: Jerry Burnett, Deputy Commissioner Date: 02/01/16
Agency: Department of Revenue

Analysis

Bill Background

This legislation is a comprehensive attempt to reform and reduce the cost of Alaska's current program of providing direct tax credit rebates and other advantages to oil and gas companies. Various credits have been added to statute since 2003, with state repurchase beginning in 2007. Through the end of FY 2015, about $7.4 billion in tax credits were received by companies. This includes both credits used against tax liability and credits repurchased by the state; it also includes activity on both the North Slope and other areas of the state.

A substantial number of companies rely on these credits to support and subsidize their Alaska operations. Currently, in many cases the state is paying 55%-65% of the cost of a project during the development phase, and up to 85% of exploration costs. These large numbers result from "stacking" multiple credits. With the transition towards a system based mostly on operating loss credits, and the repeal of the expenditure credits that are stacked with those loss credits, the state's contribution towards many projects will be reduced roughly by half.

There are several themes, or goals, of this legislation. These include:

* Reduce the state's annual cash outlay
* Protect Net Operating Loss credits especially for exploration activity
* Limit repurchases to companies who need the support
* Strengthen the minimum tax and prevent abuses to the system
* Be more open and transparent
* Honor and pay credits earned to date and through any transition period.

To address the final bullet point, above, separate legislation will be proposing an appropriation to cover any tax credits earned through the effective date. This includes the last of the credits that would have been paid in FY 2016 if not for the $500 million limit established by the governor's line-item veto, all estimated credits that would be paid in FY 2017, and credits earned in the first part of calendar year 2016 before the effective date of the bill. The transition funds will total nearly $1 billion.

In addition, separate legislation is being developed to establish a direct loan program administered by the Alaska Industrial Development and Export Authority (AIDEA). The loans will support the development of proven oil and gas reserves, providing an attractive alternative to conventional financing. The transition appropriation, as described in the prior paragraph, will endow this new loan fund with an initial deposit of $200 million.

Summary of Fiscal Impact

DOR's estimate is that this legislation will have an initial fiscal impact of $500 million per year. Of this, $400 million would be saved through reduced operating budget expenditures and $100 million would come from increased revenues. In subsequent years, the estimated impact particularly on the total amount of refunded credits is limited by DOR's current revenue and credit forecasts. DOR uses a conservative methodology to estimate future credits, and typically these figures are revised upwards as we get closer to a given forecast year.

The savings and new revenues come via three different mechanisms:

1) About $200 million in reduced expenditures, as some tax credit certificates would no longer be earned due to the repeal of certain specific credits as well as the closing of certain loopholes.

Analysis Continued

2) About $200 million in reduced expenditures, as some tax credit certificates would continue to be earned by companies but would not be immediately eligible to be turned into cash. In most cases, credit certificates would have to be held by the companies until such time as they had tax liability. At that time the certificates could be used to reduce their liability. Items #1 and #2 are addressed in the fiscal note that capitalizes the Tax Credit Fund.

3) About $100 million would be earned in additional revenue. About half of this would come through “hardening” the minimum tax floor, thus reducing the ability of companies to offset the 4% payment. The other half would come from increasing the minimum tax rate from 4% to 5%. Also, the proposed change to interest rates would raise a small amount of additional revenue.

Based on DOR's oil price forecast, prices should be sufficiently recovered by FY 2019 that it would be unlikely that one or more of the major oil producers would have a net operating loss. That will eliminate the impact of one specific floor hardening provision, reducing the additional revenue estimate.

Implementation Cost

The changes anticipated in this bill will require somewhat substantial reprogramming of the Tax Revenue Management System and Revenue Online tax portal. We have requested an estimate from the software developer, and currently assume a one-time cost of about $1,500,000 to accomplish this. We do not anticipate any additional costs to administer the tax program.

There will also be a need for substantial amendments to existing regulations to fully implement the changes.

Detail of Specific Provisions

1) Repeal of certain credits and closing of loopholes

The bill repeals the Qualified Capital Expenditure Credit (AS 43.55.023(a)) and the Well Lease Expenditure Credit (AS 43.55.023(l)). These credits of 20% and 40% respectively apply only outside of the North Slope. For companies without a tax liability, they are generally "stacked" with the carried-forward annual loss credit (AS 43.55.023(b)) resulting in total state contribution to projects in the 45%-65% range. Companies who do not have an operating loss are also eligible to receive these credits. This provides large cash subsidies to potentially profitable companies who, due to existing tax caps, effectively pay no production taxes.

The bill also eliminates a loophole that enables companies who have production of "new oil" on the North Slope but also claim a net operating loss. With the changes, companies will no longer be able to use a Gross Value Reduction to increase the size of a net operating loss credit. Current law can result in situations where the credit received can be greater than 100% of a company's actual loss.

It also eliminates another loophole that has been used by municipal utilities who also own oil or gas production. If a portion of that production is sold to an outside party, the proposed change ensures that these entities are only able to deduct or claim a pro-rated portion of their lease expenditures for the purpose of applying for credits.

2) Deferral or loss of eligibility for credit repurchase

Currently any company with less than 50,000 bbl / day of production in Alaska is eligible to have tax credit certificates repurchased by the state without limit, subject to appropriation. This legislation adds several other restrictions to repurchase. Companies that do not meet these restrictions will be required to hold their certificates until they have a tax liability. Alternatively, they can transfer their certificates to another company to use against that company's liability. The

Analysis Continued

* Any company with global annual revenue of greater than $10 billion in the past calendar year;
* Annual per-company limit of $25 million;
* Companies with any current outstanding liability to the state;
* The percentage of a given certificate that can be repurchased is limited by that company's percentage of Alaska resident hire;
* Credit certificates expire after ten years.

3) Floor hardening and other revenue increasing measures
Currently, the production tax on North Slope oil from fields not eligible for the Gross Value Reduction is limited by the 4% gross minimum tax, or "floor." Specifically, the sliding scale per-barrel credit cannot be used to reduce taxes below that level. However, there are several other credits that can reduce tax payments below the level of the floor, as far as zero. The bill makes several changes to prevent this and thus guarantee a minimum tax payment to the state.

* Prevents several credits including carried-forward annual loss credit (NOL) from being used to reduce a minimum tax payment. If one or more of the three major producers has an operating loss at the end of a tax (calendar) year, under current law, they could use their NOL credit to offset their minimum tax payments beginning in January of the next calendar year. Our current projections show this happening in 2016 and 2017. With this change, the loss credit would be held until a future year when the producer had adequate tax liability against which to offset it. This specific change is being made retroactive to January 1, 2016.
* Prevent per-taxable-barrel credits that cannot be used in a month, due to the limitation of the minimum tax, from being claimed at annual true-up of the monthly tax payments. Without this change, in years where there is substantial price volatility the state could be paying large refunds at the end of the year.
* Extends the 4% minimum tax to all North Slope production, including fields eligible for the Gross Value Reduction.

The bill also increases the tax rate of the floor itself from a variable tax rate that is 4% if the price of oil is greater than $25 per barrel, to 5% at all oil prices.

One final change that will generate additional revenue is to increase the interest rate for delinquent taxes, underpayments, and tax assessments. The new rate is designed to roughly equal the state's rate of return on its investment assets, thus reimbursing the state for its opportunity cost due to unpaid taxes.

4) Technical and non-revenue changes
The bill makes several other changes without a specific fiscal impact:

* Repeals several older and currently unused exploration incentive credit programs
* Repeals several obsolete or superseded statutory sections that refer to oil and gas production from prior years
* Ensures that the Department of Natural Resources continues to receive appropriate seismic and downhole data as a condition of receiving state credits, despite the sunset of the exploration incentive credit program
* Provides a confidentiality waiver so the state can release specific information about tax credits repurchased from individual companies.