

NEW SUSTAINABLE

ALASKA

PLAN



Pulling Together to Build Our Future

Status Report on Alaska's Fiscal Solutions

Ken Alper, Tax Division Director, Alaska Dept. of Revenue

Presentation to Southeast Conference

Haines, September 19, 2017

About me

Director of the Tax Division, Department of Revenue

- *Supervises staff of about 100 in Juneau and Anchorage responsible for collecting and administering 25 different taxes impacting many sectors of Alaska's economy*
- *Part of the Walker Administration's fiscal team planning for the transition to a sustainable revenue structure with a balanced budget*
- *Carried two Oil and Gas Tax Credit reform bills (HB247, 2016 and HB111, 2017) through the Legislature*

Legislative Staff for 10 years

- *Specialist in Oil and Gas Tax and Gasline issues, mostly working for the House Minority*

Small Business Owner in Juneau

Originally from New Jersey



The Situation

Big Picture Budget Issue

**FY18 Budget, per the Spring forecast,
will be about a \$2.5 billion deficit**

(\$4.3 billion UGF expenditures, \$1.8 billion revenue)

**Preliminary estimate for FY2019 is a
\$2.7 billion deficit**

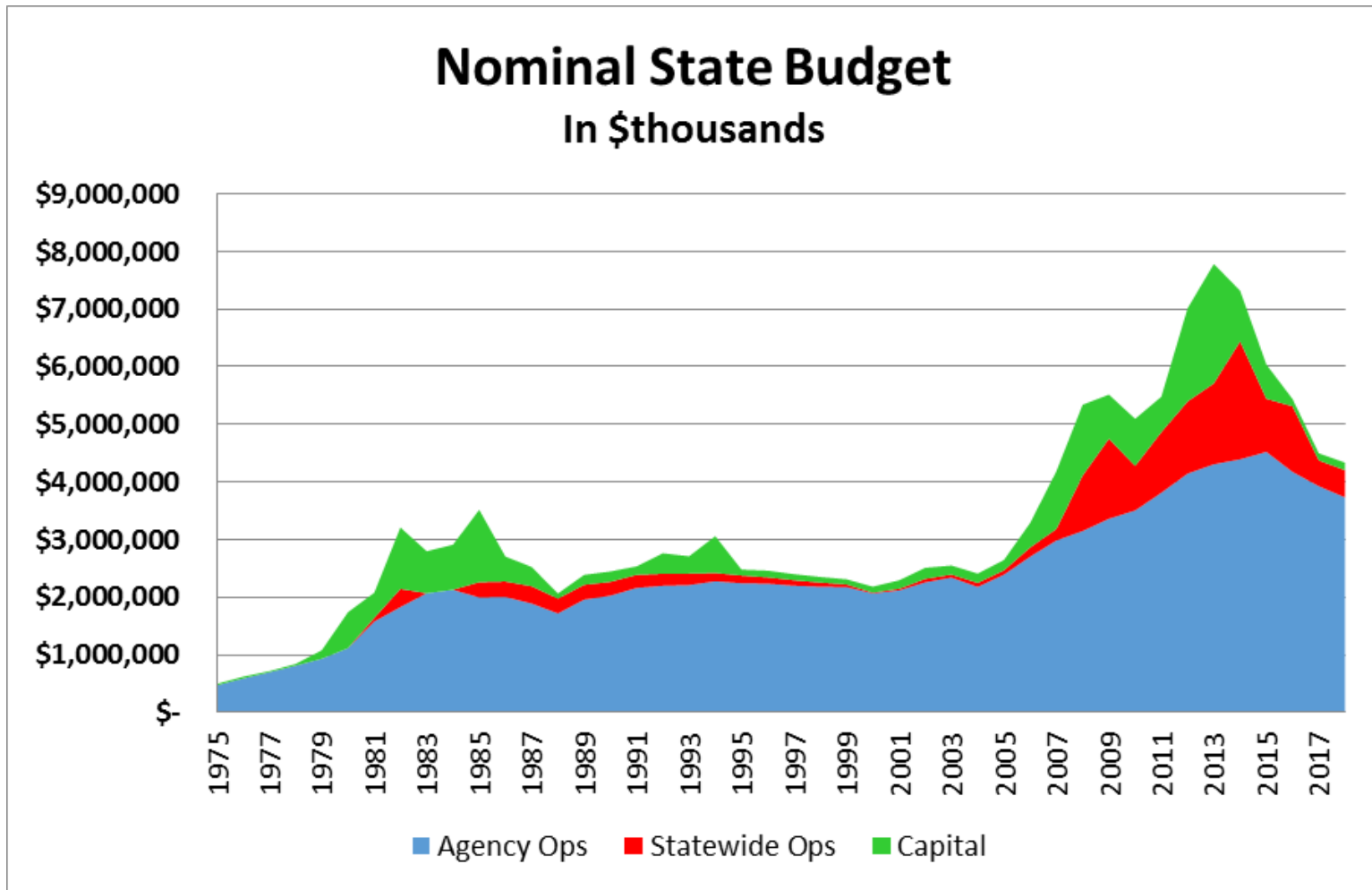
(steady oil revenue, some structural budget increase
due to certain “one time” money used last year
including \$44 million from Marine Highway Fund)

The main issue is a reduction in oil revenue

(\$billions)

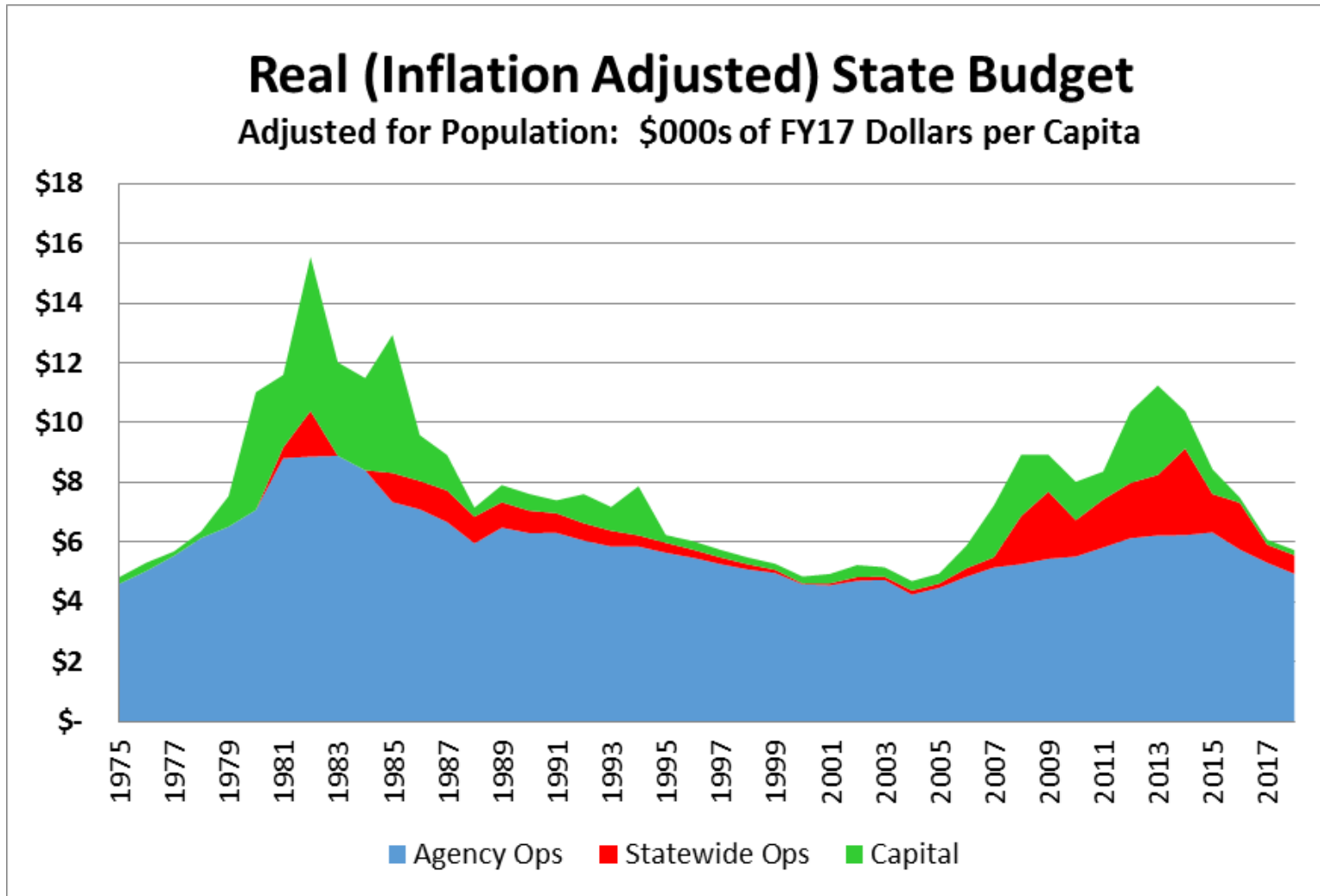
Fiscal Year	Unrestricted Oil Revenue	General Fund Budget	Overall Surplus (Deficit)
2010	\$4.9	\$5.1	\$0.4
2011	\$7.0	\$5.5	\$2.2
2012	\$8.9	\$7.1	\$2.4
2013	\$6.3	\$7.8	(\$0.9)
2014	\$4.8	\$7.3	(\$1.9)
2015	\$1.7	\$6.0	(\$3.7)
2016	\$1.1	\$5.4	(\$3.9)
2017	\$1.0	\$4.4	(\$3.0)
2018	\$1.3 est.	\$4.3	(\$2.5) est.

The budget has been cut dramatically...



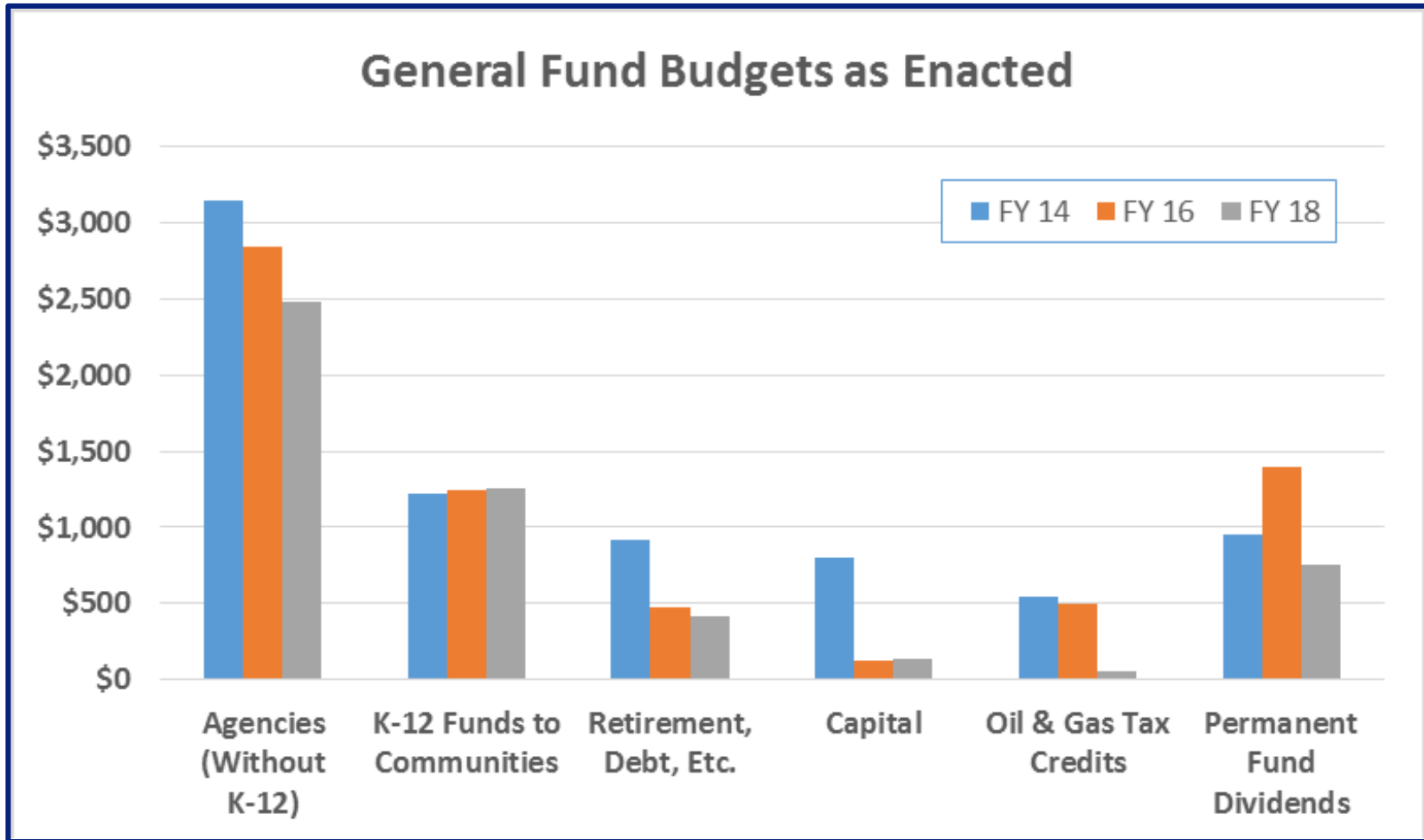
Even without considering inflation or population growth, Alaska's total budget has been reduced to 2008 levels

... to 1990s levels when adjusted for inflation and population



Major Budget Categories FY2014 to FY2018

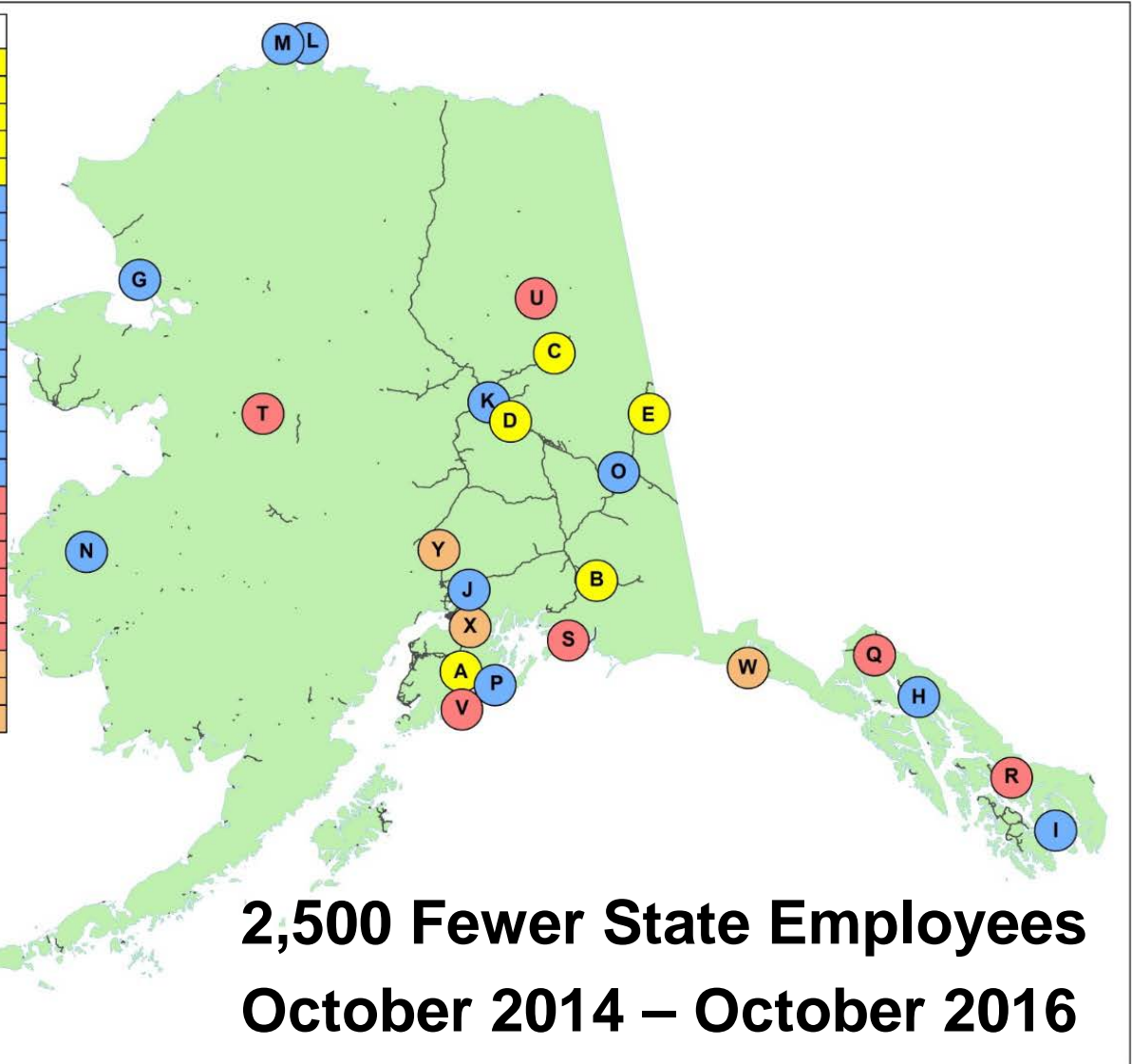
Unrestricted General Funds* (\$millions)



* PFD is not UGF

Expenditure Reductions to Date

ID	Closure
A	Seward DOT Maintenance Station
B	Chitina DOT Maintenance Station
C	Central DOT Maintenance Station
D	Salcha - Birch Lake DOT Maintenance Station
E	O'Brien Creek DOT Maintenance Station
F	Unalaska OCS Office
G	Kotzebue Job Center
H	Juneau Child Support Office
I	The Ketchikan Regional Youth Facility
J	Palmer Correctional Center
K	Fairbanks Vital Statistics Center
L	Barrow District Attorney
M	Barrow Job Center
N	St. Mary's Court
O	Tok Visitor Center
P	Seward Job Center
Q	Haines Public Health Center
R	Wrangell Public Health Center
S	Cordova Public Health Center
T	Galena Public Health Center
U	Fort Yukon Public Health Center
V	Seward Public Health Center
W	Yakutat Trooper Post
X	Girdwood Trooper Post
Y	Talkeetna Trooper Post



Savings Update

**Most of the secondary pots have been drained
Savings were reduced by \$13 billion from FY2013 through
FY2017 (not counting the current fiscal year)**

As of the End of FY17 (6/30/17) we had

- CBRF (3/4 vote to access) \$4.3 billion
- SBR (simple majority) \$0.2 billion
- Public Education Fund \$0.0 billion

That's enough to get through FY2018, but not FY2019

Plus some “hard to touch” funds

- Revenue Sharing \$0.1 billion
- Higher Education Fund \$0.3 billion
- Power Cost Equalization \$1.0 billion



The Solution

What happened in 2016 and 2017

Major Provisions of 2017 Fiscal Package:

- 1) Continued Budget Cuts
- 2) Oil and Gas / Tax Credit reform
- 3) Permanent Fund Restructuring (\$1.5 - \$2 billion)
- 4) Statewide Tax Package (\$600 - \$800 million)

Both the House and Senate passed similar versions of permanent fund restructuring, although the House's was contingent on passing both Oil and Income Tax bills

The governor didn't propose a major tax of his own, but generally supported the House's \$700 million income tax package. This was voted down in the Senate after limited committee hearings

So why do we have to fix it now?

- A major tax measure takes over a year to build
 - This fall: can start collecting 1/1/19, full revenue FY20
 - 2018 session: must wait for 1/1/20, full revenue FY21
- In the next regular session there is no way to fund the FY2019 budget with non- Permanent Fund savings
- Using Permanent Fund earnings without well established rules (i.e. unstructured draws) could result in substantial fiscal instability
- Using Permanent Fund earnings alone is not sufficient to bridge the gap (if a dividend is maintained), and is not an acceptable solution to the House
- Each year of delay reduces the sustainable future funding level by about \$150 million

Permanent Fund Restructuring

About the Fund

- Since 1976, per Art. IX, Sec. 15, 25% of all mineral royalties is deposited into the principal (corpus). Per statute, 50% of certain royalties (newer oil fields) is also deposited
- The principal cannot be spent without a constitutional amendment
- However, “...All *income* from the permanent fund shall be deposited in the general fund unless otherwise provided by law.”
- Since 1982, the dividend program is the “otherwise provided by law” part

Permanent Fund Restructuring

About the Earnings Reserve

The “ERA” tracks the running value of the “income from the fund.” It can be spent by simple majority

Money is in the earnings reserve due to:

- 1) Realized earnings (i.e. selling stock)
- 2) Rents, interest, dividends
- 3) Unrealized earnings of that portion of the fund that is in the earnings reserve

Per the APFC Monthly report 6/30/17:

Principal (corpus)	\$47.0 billion
<u>Earnings Reserve</u>	<u>\$12.8 billion</u>
Total Fund	\$59.8 billion

Permanent Fund Restructuring

Any permanent fund-based budget solution is a four step process:

1. Agree that permanent fund earnings, in some way, should be used to support government operations
2. Determine the sustainable amount that can be drawn out each year in a way that ensures that the value of the fund itself is protected and can continue to grow
3. Determine the “split” of that sustainable draw, between the people (dividend) and the government
4. Once we’ve done that, how close are we to balancing the budget and what else do we need to do?

Permanent Fund Restructuring

Principle: If we're going to use the Permanent Fund earnings, it must be governed by a formal structure, with strict **rules**

- 1) Savings Rule: Does the structure maintain a stable or growing fund value over the long term?
- 2) Draw Rule: How much is made available to spend?
- 3) Dividend Rule: How big? Flat or percentage? Based on just earnings or also other factors?

Plus, ideally, should also include:

- 4) Volatility Rule: If there is a revenue spike, does the draw decrease to prevent overheating government?
- 5) Inflation Proofing Rule: Any mechanism for formal transfers from the ERA to the Corpus?

Permanent Fund Restructuring- Options

Current Law

- Dividend is 50% of five-year average of fund income
- Some of the rest is moved from the ERA to the Corpus to “inflation proof”
- Dividend has ranged between \$878 and \$2,072 in the past 10 years. Historic average is about \$1,050
- Near term dividend calculation is over \$2,000
 - Subject to appropriation (Wielechowski v. State)
 - Will naturally decline after a stock market correction
 - Not sustainable once other savings are depleted
- Assuming inflation proofing, the remaining amount available for transfer to the **general fund would be about \$500-\$800 million**

Permanent Fund Restructuring- Options

Governor's Bill (SB 26)

“Permanent Fund Protection Act”

- Based on Senate-passed SB 128 from 2016
- Modified “Percent of Market Value”
- Annual draw is 5.25% of the average total balance
- Draw reduced by formula in high oil revenue years
- If ERA > 4 yrs need, automatic transfer to corpus
- Senate version provides 25% of draw to dividends; House version provides 33%.

Bill is now in a conference committee

- Dividend expected to be \$1,000-\$1,250 in near term
- **Provides about \$1.7-\$2.0 billion to general fund**

Major Statewide Tax

Substantial debate Income vs. Sales Tax

Several factors make income tax preferable:

- 1) Many consider any dividend cap or reduction as a regressive tax that disproportionately impacts the poor, rural Alaskans, children, etc.
 - Income tax is inherently progressive- it takes more from the highest income earners- so it is a more natural counterbalance
 - Sales tax is less progressive because high earners tend to save more of their income
- 2) Municipal concerns about sales tax impacts
 - Does the state take over statewide collection?
 - Caps on local rates? Unified exemptions?
Transaction cap?

Major Statewide Tax

Several factors make an income tax generally preferable to a sales tax (continued)

- 3) Regional price disparities would hurt rural residents with a sales tax
 - Most items from food to building supplies are substantially more expensive off the road system, which means a flat percentage sales tax would disproportionately tax those areas
 - Crafting exemptions to correct for this could greatly reduce total revenue
- 4) Based on most recent (2002-04) history of sales tax legislation, we'd expect aggressive exemption-seeking by various interest groups

Major Statewide Tax

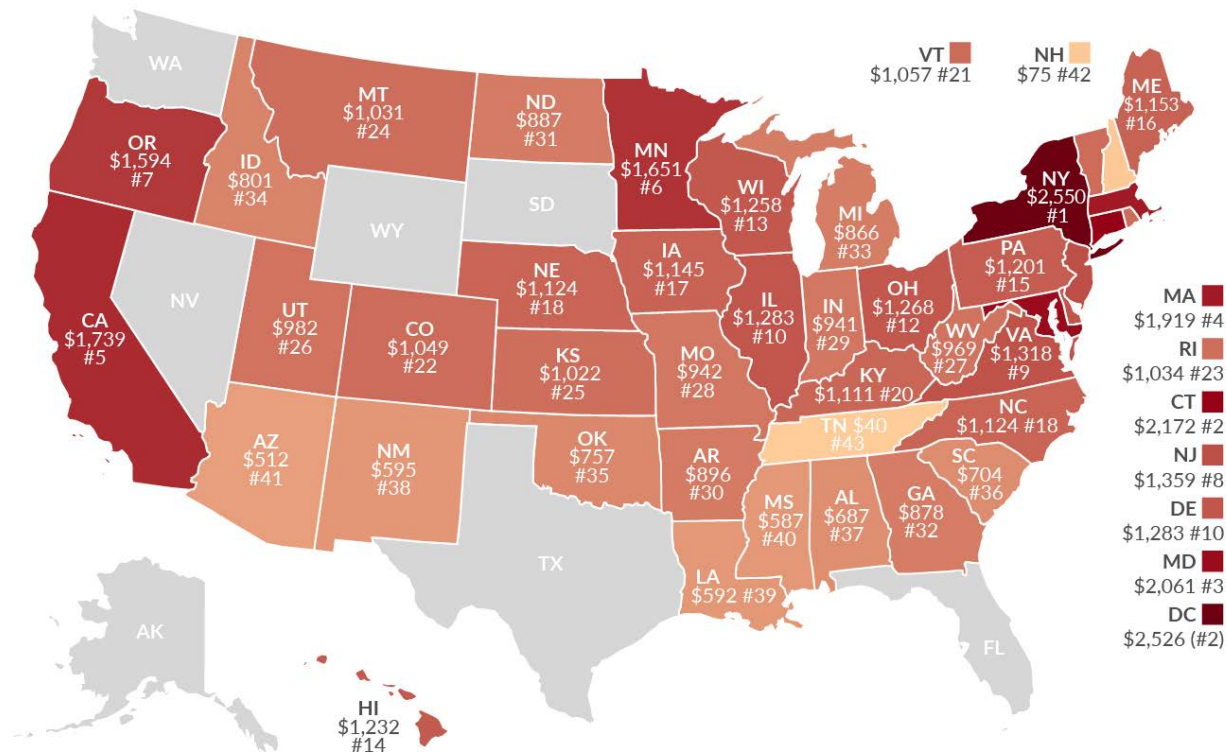
Work before and during 2017 session

- 2016 income tax bills had technical issues due to being based on old pre-1979 law
- State contracted without outside counsel to rewrite the bill based on “adjusted gross income” (bottom of 1st page of form 1040) instead of “percent of federal liability”
 - 29 of the 41 states with a full individual income tax base it on adjusted gross income
 - Structure requires decisions on rate (flat or stair-stepped) and standard deductions (to adjust for family size)
- House adopted the administration's technical language into the Finance Committee's HB115
- Bill passed the House in April, est. revenue \$700 million
- Several hearings in the Senate before it was waived out of committees and publicly and strongly voted down

Comparable Tax Burden

How Much Does Your State Collect in State and Local Income Taxes Per Capita?

State & Local Individual Income Tax Collections per Capita, FY 2013

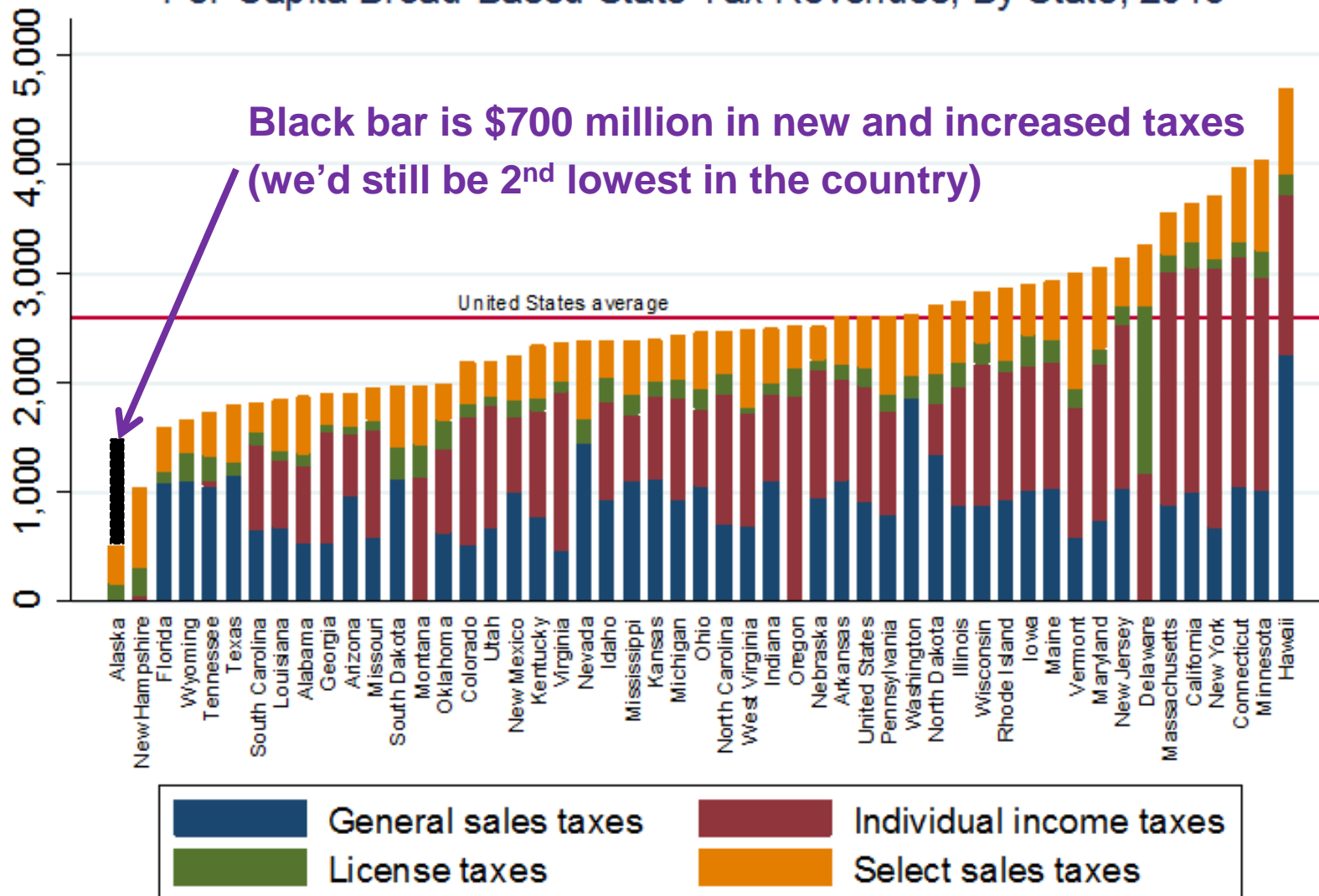


41 states with a true income tax

- Lowest (Arizona) would equal about \$350 million for Alaska
- Highest (New York) would equal \$1.8 billion
- 2017 House bill was \$700 million, which would put us in the bottom third, around the 28th highest rate

Comparable Tax Burden

Per-Capita Broad-Based State Tax Revenues, By State, 2016



Source: Mouhcine Guettabi, ISER

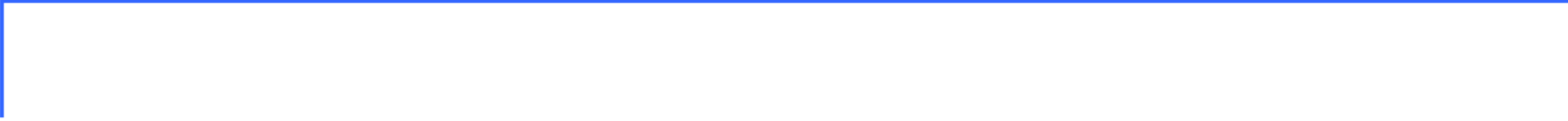
How it Comes Together

Four Parties:

1. Governor and his team is committed to a comprehensive and sustainable solution
2. House coalition came together to pass a fiscal plan. In 2017 they passed a complete package with a combination of permanent fund restructuring, an income tax, and oil tax credit reform
3. Most Senators support permanent fund changes with deeper budget cuts and a spending cap
4. The Public increasingly understands that waiting for oil prices to come back won't work this time

There is a compromise solution among these that can still be reached in 2017

And options will be much more restricted in 2018



Follow-up Notes: Oil and Gas Taxation

Oil and Gas – Recent Legislation

HB247 and HB 111 were mostly “Credit Reform”

- Elimination of cashable credits (North Slope / Mid Earth)
 - Replaced with carry-forward losses that are used once a field comes into production
 - “Ringfence” protection so losses can’t migrate to offset other taxes before new production
 - Limited “hardening” of gross minimum tax
 - Broadened support for “secondary market” for credits
- Phase out Cook Inlet credits and carry forwards
 - Tax there is very low and tied to gross volume, and the state offers no direct or indirect support after 2017
- Time limits on GVR “new oil” benefit
 - Initially passed as a permanent tax break (part of SB21)
New oil now “graduates” after 3-7 years

Oil and Gas - Work Still Needed

Remaining Issues with Oil Taxes and Credits

- Ongoing debate on “fair share” at different price points
- Outstanding credits due to the state no longer making open ended purchases (\$400 million from 2016, \$300 million from 2017, another \$200 million pending)
- Imbalance between 35% offset for spending and losses and a much lower effective tax rate on profits
- Very large future obligations (tax offsets) if major recent discoveries are developed
- Limited “upside” to the state during price spikes
- Equity between major producers and new explorers as we phase out cash credits
- High volatility and complex administration of a net profits tax system

NEW SUSTAINABLE

ALASKA

PLAN



Pulling Together to Build Our Future

Thank You!

Contact Information

Ken Alper
Tax Division Director
Department of Revenue
Ken.Alper@Alaska.gov
(907) 465-8221