Indirect Expenditure Report

January 2019

Legislative Finance Division

www.legfin.akleg.gov

Introduction

HB 306 (Ch. 61, SLA 14) requires that the Department of Revenue (DOR) and Legislative Finance Division (LFD) prepare biennial reports to the legislature on indirect expenditures. AS 43.05.095 defines an indirect expenditure as an express provision of state law that results in foregone revenue for the state by providing:

1. a tax credit or other credit;
2. an exemption, but does not include federal tax exemptions adopted by reference in AS 43.20.021;
3. a discount;
4. a deduction, but does not include costs incurred in the ordinary course of business that are deducted in the calculation of a tax under this title or in the calculation of a royalty or net profit share payment for a lease issued under AS 38; or
5. a differential allowance.

This is the third round of reports; DOR's reports were released in 2014, 2016, and 2018, and Legislative Finance released reports in 2015 and 2017. The Legislative Finance Division's report builds on the DOR report and is due to the legislature on the first day of the 2019 legislative session. While DOR's report covers all agencies each biennium, AS 24.20.235 limits the Legislative Finance report to a few agencies each biennium.

For the 2015 report Legislative Finance covered the following departments, which will be revisited in the 2021 report:

1. Commerce, Community and Economic Development;
2. Fish and Game;
3. Health and Social Services;
4. Labor and Workforce Development; and
5. Revenue.

For the 2017 report, Legislative Finance covered the following departments, which will be revisited in the 2023:

6. Administration;
7. Alaska Court System (Judiciary);
8. Education and Early Development, including the Alaska Student Loan Corporation and Alaska Commission on Postsecondary Education;
9. Environmental Conservation;
10. Natural Resources; and
11. Transportation.

Legislative Finance's 2019 report is designated to cover all agencies not reviewed in 2015 or 2017. However, none of the remaining agencies (such as the University of Alaska and the Alaska Railroad) have participated in the Indirect Expenditure reporting process up to this point. Therefore, there are no agencies to review. If legislators wish to see the report cover these agencies, the statutory definition of indirect expenditures may need to be revisited.

Legislative Finance has elected to provide updated reviews of the five provisions that are set to sunset in 2019 or 2020. Of these reviews, LFD opted to conduct a more in-depth analysis of the Salmon and Herring Product Development Tax Credit. This review was not required by statute, but could be useful to legislators.

In the 2021 report, LFD will be required to analyze the same group of provisions as in the 2015 report. Many of the provisions will not require further analysis, so that report could include more in-depth review of some provisions. The process set up in 2014 could be altered to create a process for these reviews. In some states, the equivalent of Alaska's Legislative Budget and Audit committee designates a few provisions for review each year. In others, the reviewing agency itself sets a schedule for in-depth reviews. In either case, the process is aimed at allowing time for thorough reviews of a few provisions. As all provisions have now been at least superficially reviewed, a more detailed look at certain provisions would likely yield more useful information going forward.

Summary of Recommendations			
Department	**Applicable Program**	**Indirect Expenditure Name**	**Recommendation**
Health and Social Services	SHARP II	Health Care Professions Loan Repayment and Incentive	Allow to sunset
Revenue	Corporate Income Tax	In-State Refinery Tax Credit	Allow to sunset
Revenue	Corporate Income Tax	LNG Storage Facility Credit	Allow to sunset
Revenue	Fisheries Business Tax	Salmon and Herring Product Development Credit	Continue, with modifications
Revenue	Fisheries Resource Landing Tax	Community Development Quota Credit	Continue, remove sunset

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Health and Social Services

Applicable Program
SHARP II

Indirect Expenditure Name
Health Care Professions Loan Repayment and Incentive

Department of Revenue Submission per AS 43.05.095

(1) Description of Provision
Waives employers' share of repayment of educational loans to provide a direct incentive for certain health care professionals.

(2) Type
Waiver

(3) Authorizing Statute, Regulation or Other Authority
AS 18.28; 7 AAC 24

(4) Year Enacted
2012

(5) Sunset or Repeal Date
2019 - sunset report submitted 12/2018

(6) Legislative Intent
Increase access to health care in rural Alaska.

(7) Public Purpose
Increase access to health care in rural Alaska.

(8) Estimated Revenue Impact
FY 2013 - Program not in existence.
FY 2014 - $82,493
FY 2015 - $73,337
FY 2016 - $49,736
FY 2017 - $6,783
First invoices began in FY 2014.

(9) Cost to Administer
Estimated at less than $12,500 annually, based on percent of staff processing time.

(10) Number of Beneficiaries / Who Benefits
All Alaskans, particularly in rural areas. Up to 90 health care facilities and practitioners.

Legislative Finance Analysis per AS 24.20.235

(1) Estimate of Annual Revenue Foregone by the State
Historically, the program cost $53 thousand on average. Due to budget cuts, the program is no longer active (as of FY19) and all contracts have been executed.

(2) Estimate of Annual Monetary Benefit to Recipients
$589

1.1

Health and Social Services

Applicable Program
SHARP II

Indirect Expenditure Name
Health Care Professions Loan Repayment and Incentive

Legislative Finance Analysis per AS 24.20.235

(3) Legislative Intent Met?
Yes

(4) Should it be Continued, Modified or Terminated?
Recommend that Sharp 2 sunset as the Department is working with stakeholders on a Sharp 3 option that will allow more flexibility for occupations and locations and will be funded 100% by the employers (no UGF).

Revenue

Applicable Program
Corporate Income Tax

Indirect Expenditure Name
In-State Refinery Tax Credit

Department of Revenue Submission per AS 43.05.095

(1) Description of Provision
This is a credit for qualified infrastructure expenditures for in-state oil refineries. The credit may not exceed the lesser of 40% of total qualifying expenditures or $10 million per refinery per tax year. The credit can be applied against corporate income tax liability and carried forward, or refunded.

(2) Type
Credit

(3) Authorizing Statute, Regulation or Other Authority
AS 43.20.053

(4) Year Enacted
2014

(5) Sunset or Repeal Date
Sunset on 12/31/2019

(6) Legislative Intent
To encourage investment in infrastructure improvements and help maintain economic viability of the in-state refining industry.

(7) Public Purpose
Maintain or expand in-state refining industry jobs and related economic activity; to maintain in-state sources of refined products.

(8) Estimated Revenue Impact
FY 2013 - Credit not in effect.
FY 2015 - Confidential due to small number of recipients.
FY 2017 - FY 2017 incomplete.
Note: All returns with tax periods beginning in FY 2017 have not yet been received, so FY 2017 data is incomplete.

(9) Cost to Administer
No additional cost; is administered with current resources.

(10) Number of Beneficiaries / Who Benefits
Fewer than 5 companies.

Legislative Finance Analysis per AS 24.20.235

(1) Estimate of Annual Revenue Foregone by the State
Unknown

(2) Estimate of Annual Monetary Benefit to Recipients
Unknown

(3) Legislative Intent Met?
Unclear

Revenue

Applicable Program
Corporate Income Tax

Indirect Expenditure Name
In-State Refinery Tax Credit

Legislative Finance Analysis per AS 24.20.235

(4) Should it be continued, modified or terminated?

Recommend that the provision be allowed to sunset as scheduled. The credit was created after the closure of the Flint Hills refinery in 2014. While no further refineries have closed, there is no evidence that the tax credit played any part in that.

Revenue

Applicable Program
Corporate Income Tax

Indirect Expenditure Name
LNG Storage Facility Credit

Department of Revenue Submission per AS 43.05.095

(1) Description of Provision

This is a credit for the costs incurred to establish a storage facility for liquefied natural gas. The credit is the lesser of $15 million or 50% of costs incurred to establish the facility. It applies to facilities with a minimum storage capacity of 25,000 gallons of LNG and that are public utilities regulated by the Regulatory Commission of Alaska.

(2) Type

Credit

(3) Authorizing Statute, Regulation or Other Authority

AS 43.20.047

(4) Year Enacted

2012

(5) Sunset or Repeal Date

12-31-19

(6) Legislative Intent

To provide an incentive to encourage the construction of an LNG storage facility.

(7) Public Purpose

To encourage construction of LNG storage facilities, thereby reducing the potential for gas shortages during peak demand

(8) Estimated Revenue Impact

FY 2013 - $0
FY 2014 - $0
FY 2015 - $0
FY 2016 - $0
FY 2017 - $0

(9) Cost to Administer

No additional cost; is administered with current resources.

(10) Number of Beneficiaries / Who Benefits

0

Legislative Finance Analysis per AS 24.20.235

(1) Estimate of Annual Revenue Foregone by the State

None

(2) Estimate of Annual Monetary Benefit to Recipients

None

(3) Legislative Intent Met?

No

Revenue

Applicable Program
Corporate Income Tax

Indirect Expenditure Name
LNG Storage Facility Credit

Legislative Finance Analysis per AS 24.20.235

(4) Should it be continued, modified or terminated?

Recommend the provision be allowed to sunset as scheduled. The credit was not used and does not appear to be necessary to meet current energy demands. The sunset date was chosen to avoid any impact on future LNG projects.

Revenue

Applicable Program
Fisheries Business Tax

Indirect Expenditure Name
Salmon and Herring Product Development Credit

Department of Revenue Submission per AS 43.05.095

(1) Description of Provision
A non-transferable credit for eligible capital expenditures to expand value-added processing of Alaska salmon and herring. The credit is 50% of qualified investments up to 50% of tax liability incurred for processing salmon and herring during the tax year. The credit may be carried forward for three years. Herring was added to the credit in 2014.

(2) Type
Credit

(3) Authorizing Statute, Regulation or Other Authority
AS 43.75.035

(4) Year Enacted
2003, last amended 2014

(5) Sunset or Repeal Date
Sunset on 12/31/2020

(6) Legislative Intent
The Legislature intended to encourage the development of value-added salmon and herring products in Alaska and to increase the value of Alaskan fisheries.

(7) Public Purpose
To encourage the production of value-added seafood products in Alaska and increase the value of Alaskan fisheries.

(8) Estimated Revenue Impact
FY 2013 - $1,832,081
FY 2014 - $-397,376
FY 2015 - $945,621
FY 2016 - $3,939,376
FY 2017 - $3,255,429
Note: The FY 2014 number is negative as a result of adjustments to prior year credits.

(9) Cost to Administer
No additional cost; is administered with current resources.

(10) Number of Beneficiaries / Who Benefits
Approximately 15 processors .

Legislative Finance Analysis per AS 24.20.235

(1) Estimate of Annual Revenue Foregone by the State
Estimated to be $3-4 million annually

(2) Estimate of Annual Monetary Benefit to Recipients
Approximately $127,000 per processor

Revenue

Applicable Program
Fisheries Business Tax

Indirect Expenditure Name
Salmon and Herring Product Development Credit

Legislative Finance Analysis per AS 24.20.235

(3) Legislative Intent Met?
Unclear

(4) Should it be Continued, Modified or Terminated?
See following pages.

Revenue

Salmon and Herring Product Development Tax Credit

Recommend modification to enable better data collection. In 2014, the legislature modified the credit to allow the credit to be used for herring equipment. This analysis will separately analyze the effectiveness of the credit for salmon and herring.

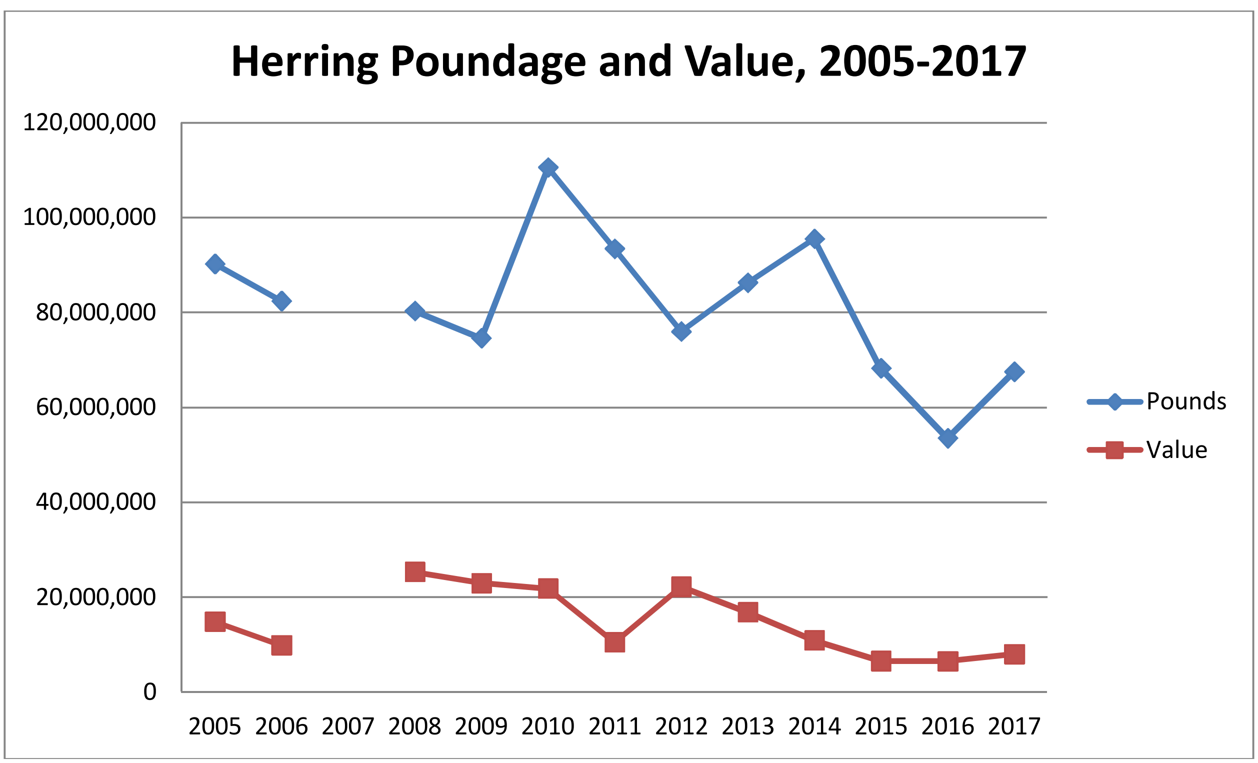
The legislative finance division recommends modifying confidentiality rules to enable publication of more complete data on credit usage for all credits. Release of some information should be allowed as a condition of receiving tax credits.

Herring

The Department of Revenue is unable to disclose the amount of the credit that has been used for herring because of confidentiality - too few processors are using the credit to report the amounts.. Without knowing this information, it is impossible to evaluate whether the credit has been cost effective.

When the credit was expanded to herring, the rationale was to create a stronger market for herring. The bill sponsor and industry groups testified that the herring sac roe fishery created significant waste from the male fish, which were discarded. The credit would allow for the purchase of canning equipment that could utilize this waste stream as a commercial product.

Herring poundage and value has decreased since 2014, however. The graph below illustrates the change in poundage and value since 2005 (note, data is unavailable for 2007). Based on this data, the credit does not appear to have successfully improved the market for herring - the value of the fishery has continued its decline that began before 2014.



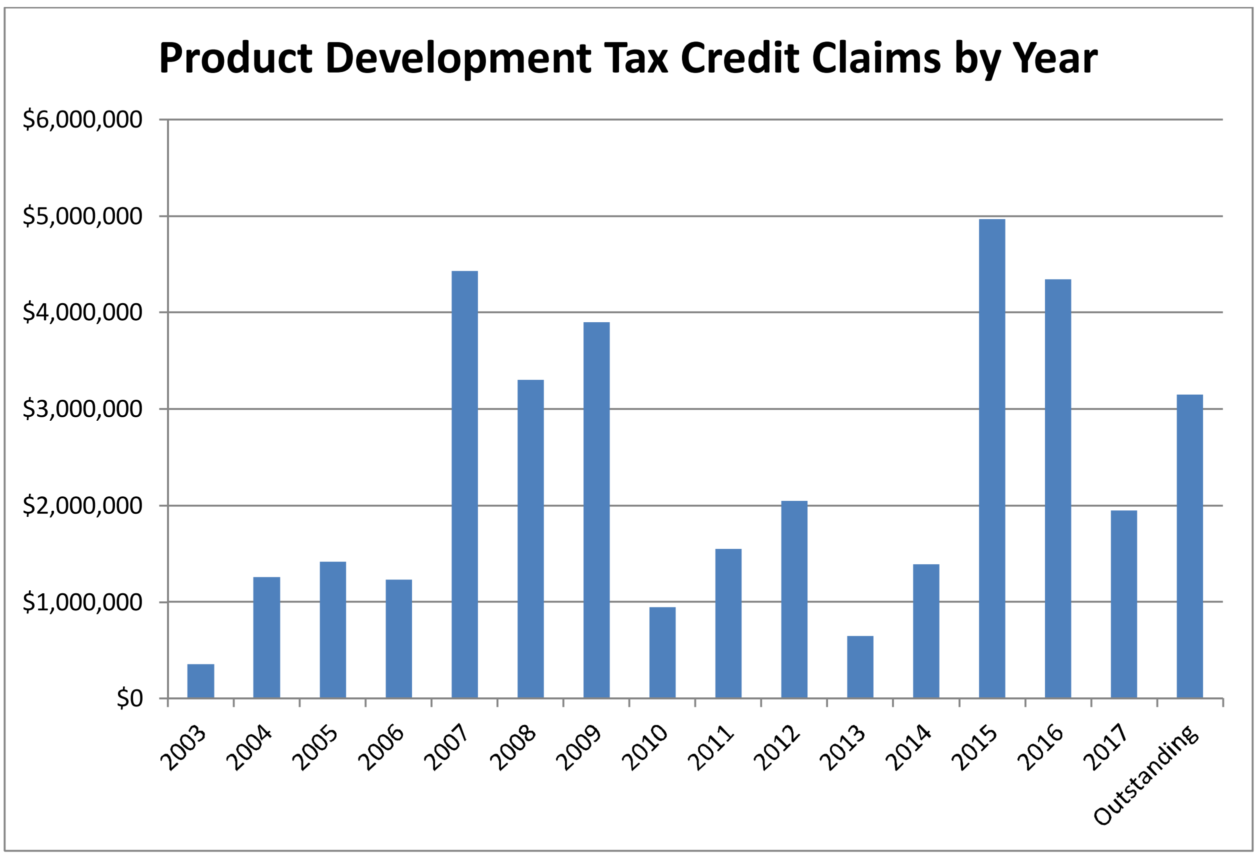
Revenue

Without data about the credit usage, LFD is unable to make a recommendation as to whether this credit should be continued or not. Therefore, LFD recommends changing confidentiality rules to allow data regarding the usage of the credit -- and all credits --to be disclosed. Without this information, it is impossible for the legislature to make an informed decision on this credit.

Salmon

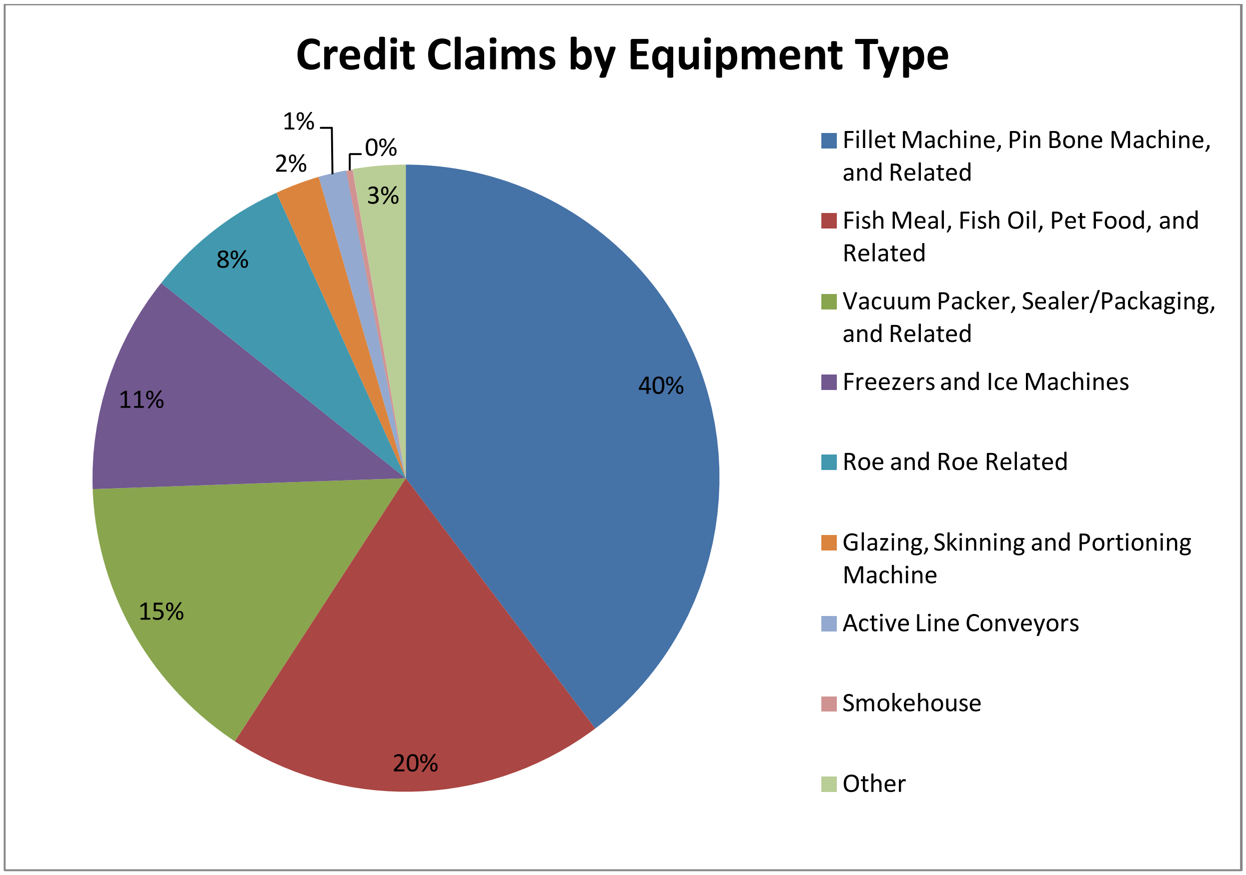
The salmon portion of the credit was heavily utilized in 2015 and 2016 after the credit was modified, but usage declined in 2017. In the five years preceding the 2014 changes, credit utilization averaged $1.3 million per year. It then spiked to nearly $5 million in 2015 and $4.3 million in 2016, before falling to $2 million in 2016. This indicates that the changes to the credit likely did result in processors investing in new equipment, as the legislature intended.

The graph below shows the credits applied by year since the credit's inception in 2003. Since 2009, credit claims have averaged 12% of the Fisheries Business Tax revenue attributable to salmon.



The credit has been utilized for a wide variety of equipment, as the following graph shows. The data covers the entire period since the credit's inception, and so it does not show trends over time. According to DOR, there are confidentiality concerns with releasing year-by-year data on how the credit is being utilized. This data would allow the legislature to see to what extent the industry is utilizing new categories as they are added.

Revenue



In evaluating the effectiveness of a tax credit, a key question is the "but for" question: but for the credit, would the activity have occurred? In the case of this credit, has it had a significant impact on salmon prices? It is impossible to answer this question statistically in this case because the credit has been around continuously for 15 years, making it difficult to separate the impact of the credit from other effects. This is particularly difficult because each salmon species has its own price and catch fluctuations, and DOR does not have data separating usage by species.

Anecdotally, there is a reasonable case that the credit has had a significant positive impact on the salmon industry. Strong pink salmon returns in recent years have flooded the market, and canned products are crucial to maintaining value for that species. It is plausible that without the credit, processors would not have the equipment needed to provide a market for this species, and that the credit pays for itself. For example, according to the Department of Fish and Game, the 2017 pink salmon harvest accounted for $169 million of ex-vessel value. At the 4.5% cannery tax rate, that would be revenue of $7.6 million.

Unfortunately, we do not have the data necessary to verify or disprove this narrative. The credit's longevity and the global nature of the salmon market make statistical analysis of this question very difficult.

In previous sunset extension bills for this credit, the legislature has added new eligible categories of expenditures in response to industry requests. For example, the 2014 extension bill added expenditures

Revenue

relating to converting equipment to smaller can sizes. Previous extension bills added other items such as ice machines.

LFD recommends that the salmon product development tax credit be continued. For the credit to continue to be effective, it may need to be extended to new equipment types as the market changes, as had happened in previous extension bills.

Revenue

Applicable Program
Fisheries Resource Landing Tax

Indirect Expenditure Name
Community Development Quota Credit

Department of Revenue Submission per AS 43.05.095

(1) Description of Provision
A non-transferable credit for contributions to an Alaska nonprofit corporation that is dedicated to fisheries industry-related expenditures. The credit is available only for fishery resources harvested under a community development quota (CDQ). The credit is 100% of contribution amount up to a maximum of 45.45% of tax liability on fishery resources harvested under a CDQ.

(2) Type
Credit

(3) Authorizing Statute, Regulation or Other Authority
AS 43.77.040

(4) Year Enacted
1993, last amended 2014

(5) Sunset or Repeal Date
Sunset on 12/31/2020

(6) Legislative Intent
The Legislature intended to provide a tax credit to encourage CDQ programs to contribute to nonprofits that provide jobs and training in Western Alaska.

(7) Public Purpose
To provide jobs and training in Western Alaska.

(8) Estimated Revenue Impact
FY 2013 - $490,371
FY 2014 - $411,144
FY 2015 - $571,581
FY 2016 - $556,529
FY 2017 - $738,168

(9) Cost to Administer
No additional cost; is administered with current resources.

(10) Number of Beneficiaries / Who Benefits
Between 10 and 20 corporations.

Legislative Finance Analysis per AS 24.20.235

(1) Estimate of Annual Revenue Foregone by the State
None

(2) Estimate of Annual Monetary Benefit to Recipients
$36,867

Revenue

Applicable Program
Fisheries Resource Landing Tax

Indirect Expenditure Name
Community Development Quota Credit

Legislative Finance Analysis per AS 24.20.235

(3) Legislative Intent Met?

Yes

(4) Should it be Continued, Modified or Terminated?

Recommend continuation. Per AS 43.77.050, the credit is taken against the muncipal share of the tax, not the state share. Therefore, no revenue is foregone by the state. Instead, this credit redirects revenue from municipalities to CDQ groups. A sunset provision is unnecessary for this provision from the State's standpoint since no revenue is foregone by the State. However, municipalities that are impacted may prefer to keep the sunset in place.