From:	Bushnell, Aimee D (DOR)
To:	Sonja Kawasaki
Cc:	GOV.Legislative.Office; Crum, Adam R (DOR); Limani, Fadil (DOR); Smyth, Llewellyn C (DOR); Sanders, Lacey M (GOV)
Subject:	DOR Response to Questions on SB 92
Date:	Tuesday, March 11, 2025 3:23:02 PM
Attachments:	DOR Response to Sonja Kawasaki 03.11.25.pdf

Hello,

The Department of Revenue has received your questions regarding Senate Bill 92. Please see attached our response to those questions.

Please let me know if there is anything else I can help with.

Respectfully,

Aimee Bushnell
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THE STATE of ALASKA
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March 11, 2025

Sonja Kawasaki
Senate Majority Counsel
Alaska State Capitol
Juneau, AK 99801

Dear Sonja Kawasaki,

The Department of Revenue (DOR) has received your questions regarding Senate Bill 92. Please see your requests and our responses below.

1. ***One of the senators attending the meeting asked me to seek clarification on one of the scenarios raised. The scenario asked, in essence, how DOR would treat the following associated group of entities if SB 92 became law:***
   (1) Oil Producer, LLC
   (2) Oil Producer Pipeline Company, LLC
   (3) Oil Producer Jack-Up Rig Company, LLC
   (4) Oil Producer Gas Storage Company, LLC
   (5) Oil Producer Gas Import Facility Company, LLC

   Under the IRS unity test and state regulations, these five companies would be treated essentially as "one energy company" for Alaska income tax purposes. And from a related discussion earlier in the meeting, that the $5 million threshold (deduction) of SB 92 for taxable income would be applied to the group's combined taxable income, rather than on a per-company basis. Did I understand these explanations correctly?

Yes, the group of five companies will be treated as "one energy company" for State filing purposes, assuming the appropriate tests for a unitary business have been met.

2. ***The above request for clarification prompts related questions. Let's say a jack-up rig company, a gas storage company, and a gas import facility company (similar to items (3), (4), and (5) above) each exist as LLCs that may or may not be associated with one another—but none are associated with an oil producer or pipeline transportation company.***

   a. ***Under the policy of SB 92, such entities would not owe taxes, despite that had they been associated with a producer or pipeline transportation company then IRS unity rules would require them to pay taxes. Is this correct?***

"Unity" is a state tax concept. The entities (or their owners) will be subject to federal tax under IRS rules regardless of affiliation. State law follows the federal tax treatment of an entity. If, in this example, none of the entities have elected corporate status, and none are owned by a corporation, then the entities will not pay State tax.

b. In this instance, what if the stated gas import facility company purchased 1.0 percent of TAPS; would that interest subject the gas import facility company's income to taxation under SB 92 and under the IRS unity test? If the answer is that "it depends"—what sorts of factors are weighed?

If the gas import facility were an LLC under SB 92 and it purchased a one percent interest in TAPS, then yes, that gas import facility LLC will become subject to tax under SB 92 if it has taxable income equal to or greater than $5 million. Current regulations will attribute that 1 percent TAPS interest to its owner. Under 15 AAC 20.320, TAPS is a regulated oil pipeline, so an ownership interest triggers the "transportation" aspect of SB 92.

3. ***While discussing the above hypothetical, Ken Alper posed adding to the associated list, in essence, Oil Producer Cake Bakery, LLC. Mr. Williams responded that IRS rules would not combine this bakery entity's profits with those of the others' for taxing purposes, due to the differing character of the business. Is this correct?***

"Unity" is a rebuttable position under State law and judicial precedent. Under the Internal Revenue Code (IRC), an oil & gas LLC could own a bakery LLC and consolidate in the same federal tax return, if filing as corporations. IRS rules do not distinguish lines of business for consolidation purposes but look more to the ownership. Federal tax treatment of the two LLCs matters. Two separate LLCs that are discretely owned business entities, but not corporations, cannot consolidate in the same return. Assuming both entities were owned by the same individual, the results of the two entities may pass through to a single individual return, but even then, certain rules determine whether losses of one can offset the income of the other.

For state tax purposes, an analysis of the indicia of unity will determine whether a bakery could combine with an oil & gas company in the same state return. Two cases from the Alaska Supreme Court have established the judicial precedent in Alaska for the tests of a unitary business. In short, the standard is fairly broad such that a bakery could conceivably be combined with an oil & gas producer if the factors of unity are present. [See Earth Resources Co. of Alaska v. State of Alaska, 665 P2d 960 (1983); Alaska Gold Co. v. State of Alaska, 754 P2d 247 (1988)].

4.*In the DOR Word document that was attached to supplement the PDF "redline" of the bill itself, DOR included a subsection (j). Is this subsection meant to eliminate the potential for "double taxation" of a taxpayer?*

Yes, the intent of the proposed subsection (j) is intended to eliminate the potential double taxation of the same income flowing to a taxpayer.

5. ***Under the proposed new subsection (j), lines 13-14, there is language that reads "a qualified entity may deduct from income a payment received from a direct member when." Is "a payment received from" here correct, or should it provide for "a payment to" a direct member?***

The "to" or "from" at subsection (j) depends on where SB 92 intends the incidence of tax to occur. If the intent of SB 92 is to apply tax at the lowest possible level, i.e., the pass-through entity conducting business in Alaska, then the deduction for tax paid occurs at a higher level such that "from" is the appropriate term. For example:

Oil & gas producer Alaska, LLC ("AK LLC") is an entity owned 50 percent by Corporation 1 and 50 percent by Individual 2. For federal tax purposes, AK LLC files a partnership return. Under existing corporate tax law, income from the portion of the LLC owned by the corporation automatically flows into the corporate tax return filed by Corporation 1. The other 50 percent owned by Individual 2 is not taxed, because there is no state individual income tax. AK LLC has more than $5 million in taxable income under SB 92. AK LLC would pay its state tax under SB 92, but Corporation 1 is also subject to tax under AS 43.20.144. Corporation 1 would be double taxed on the income from AK LLC but for a deduction of income received from a direct member.

6. ***In SB 92 Draft N, you suggest deleting lines 14-16. That language was intended to prevent a taxpayer from giving payments to owners, shareholders, etc., and family and friends in the form of salaries, bonuses, dividends, gifts, etc., thereby reducing the entity's tax lability while conferring a financial benefit to those individuals. Does DOR's proposed subsection (j) also address concerns that were attempted to be covered under Draft N's lines 14-16?***

If the proposed amendments tax qualified entities as if they are a C-corporation, then under federal rules the corporation cannot take a deduction for payments of dividends. Deductions for gifts are limited to a nominal amount that would not permit shifting of substantial amounts of income. Federal tax law permits deduction of reasonable compensation and generally limits excessive or unreasonable compensation. If the intent of SB 92 is to prohibit any compensation to an owner, partner, member, or shareholder, then that subsection could be reinstated.

7. ***Under DOR's subsection (j), could we include a third stipulation that such payment "does not include a transfer of property"? Does DOR have thoughts or an objection to that? That condition has appeared in other drafts of other versions of S-Corp tax bills and seems like it would address something different than the other two listed conditions.***

This is covered by the definition of "payment" at proposed amendment to AS 43.20.340 to exclude the transfer or distribution of property. That could be moved to subsection (j) if the sponsor prefers.

8. ***Is the use of the phrase "income" on line 13 and on line 14 correct in context, or under this bill should the term used in each of those two places be "taxable income"?***

"Income" is the correct term in context of subsection (j). Using the example at #5 above, the corporation's share of income as stated on the federal partnership Form K-1 will be different than the taxable income of "AK LLC". The taxable income of AK LLC could be something greater than the actual pass-through share of income to Corporation 1. For that reason, only the actual income passed through to Corporation 1's tax return can be deducted.

9. ***At the bottom of DOR's redlined bill, there is a reference to "draft 1/8/2021 lines 23-29"—we assume this is an inadvertent remnant from an internal DOR document but wanted to confirm.***

Yes, that is an inadvertent remnant from an internal DOR document and can be ignored.

10. ***I see on the IRS site that an LLC can elect to file federal taxes as a corporation (and from there, can choose to file as an S-Corp, if meeting certain requirements). Under current Alaska law, if an LLC elects to file federally as a corporation, and does not file as an S-Corp, does the LLC file taxes as a corporation in Alaska? Or is the answer "no"—only if they are actually formed as a corporation, in accordance with AS 43.20.030(a)?***

If an LLC has made a federal election to file as a corporation (C-Corp), then yes, it must file an Alaska corporate tax return and pay taxes as a C-corporation (non-S). Alaska tax code adopts the Internal Revenue Code by reference, including most of its rules, definitions, and interpretations. For that reason, Alaska follows the federal tax treatment (elections) an entity has made.

11. ***Under SB 92 or a similar bill to tax for-profit non-Corporation entities, and under current Alaska law, will the entities be required to file their taxes the same way as they do federally? I ask this question because I'm wondering now if, for example, an LLC can "elect" to file as a corporation for federal tax purposes (obtaining the 21 percent reduced tax rate), but then—potentially under the incorporated-by-reference the IRS code, or by an oversight in an enacted bill—"elect" to file as an LLC for Alaska tax purposes (obtaining the $5 million threshold-deduction, in the case of SB 92).***

SB 92 would not permit two different elections. SB 92 Sec. 1: AS 43.20.019 (b) [pg. 1 lines 9 – 10] states that this section does not apply to a corporation paying tax under AS 43.20.011. AS 43.20.021(a) adopts the Internal Revenue Code by reference and AS 43.20.300(b) adopts interpretations of the Internal Revenue Code by reference. An LLC that has elected federal tax treatment as a corporation (non-S) is bound by that election for state tax purposes. Therefore, such entity would file and pay tax under AS 43.20.11 and not be subject to AS 43.20.019 (SB 92).

Please let me know if I can be of further assistance.

Adam Crum
Commissioner

cc: Jordan Shilling, Director, Governor's Legislative Office
Lacey Sanders, Director, Office of Management and Budget