House Bill 130
Corporate Income Tax Reform

Representative Adam Wool
Presentation to the House Resources Committee
April 21, 2021

What Does HB130 Do?

Three separate reforms to Alaska's Corporate Income Tax, each closing a loophole or exemption that costs the state money

1. Federal CARES Act loss-carryback issue forces the state to pay large tax refunds;
2. Oil and gas companies who are not "C" corporations do not have to pay the same tax as those who do;
3. Several smaller tax credits or "indirect expenditures" that don't appear to have any current purpose or value

…but first a little background on our Corporate Income Tax

Alaska's Corporate Income Tax

- All states have some sort of corporate taxation
- State taxes are typically tied to the federal corporate income tax
  - National ("water's edge") profits are apportioned to Alaska based on certain key ratios:
    - Percentage of Sales, Property, and Payroll
    - Based on the federal "UDITPA" (Uniform Division of Income for Tax Purposes Act), which we adopted in 1959
  - For oil and gas taxpayers, Alaska has set up a separate, parallel system. The same tax rates apply, but a different formula:
    Global profits are apportioned to Alaska based on different ratios
    - Percentage of Sales, Property, and Extraction (i.e. production)
- Tax is paid based on apportioned Alaska profits based on the tax table in AS 43.20.011. Top marginal rate is 9.4% of profits above $222,000.

Who Pays This Tax?

- "C" Corporations. Legally these are entities that hold the company's assets and income separate from that of the individual owners of the company
  - Profits are retained within the company and taxed separately
- All corporations have to file a tax return with the Department of Revenue, but type "S" corps are currently exempt from the actual tax
- About 17,000 file tax returns, but only the 6,000 "C" Corps are liable to pay
- DOR reports the tax collections separately for oil and non-oil companies
  - Oil tax is quite "elastic" with oil prices; average of the last five years is only $33 million, but over $500 million / year during the 2005-2014 period
  - Non-oil tax is much more stable; average of the last five years was $103 million and was $123 million / year during the 2005-2014 period
- Overseen by a staff of about 16 auditors and tax technicians in Anchorage and Juneau

Who Pays This Tax?

- Non-oil Corporate taxes are paid from many sectors of the economy

CORPORATE INCOME TAX COLLECTIONS
by Sector for Corporations Subject to AS 43.20.145

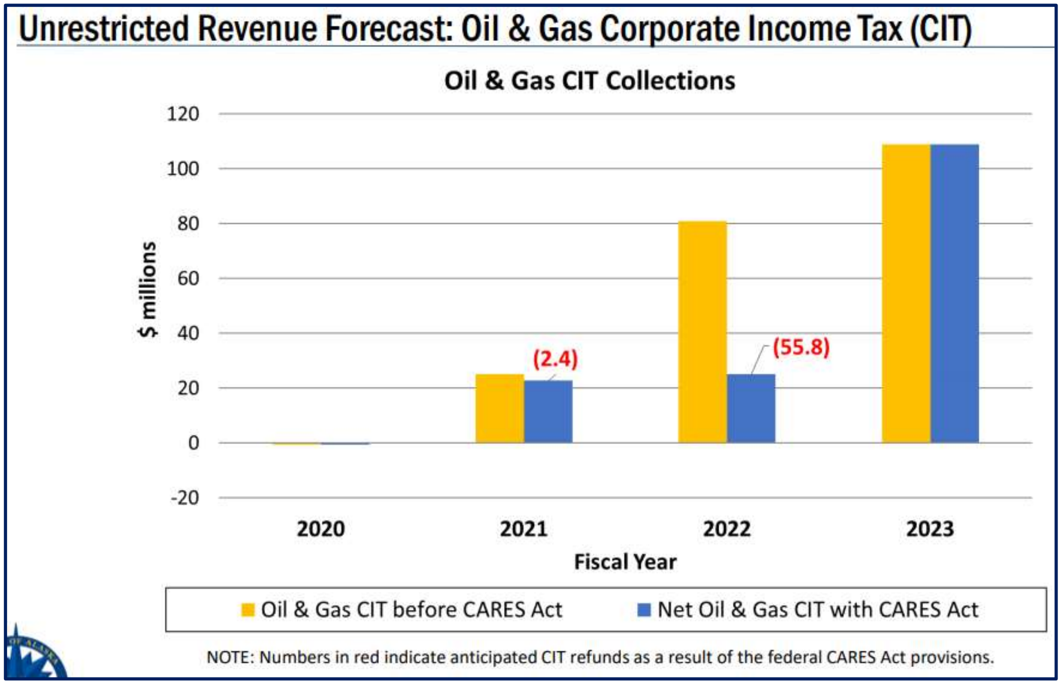
	FY 2017		FY 2018		FY 2019		FY 2020	
Sector	**%**	**Collections**	**%**	**Collections**	**%**	**Collections**	**%**	**Collections**
Construction	4%	$3,419,176	2%	$2,077,330	2%	$2,109,369	2%	$1,530,911
Finance	18%	$15,085,673	14%	$17,676,096	13%	$15,045,614	20%	$18,063,012
Fisheries	1%	$668,485	2%	$2,580,410	2%	$2,766,586	0%	($276,142)
Manufacturing	0%	$204,327	0%	$326,349	0%	$139,585	0%	$203,268
Mining	-1%	($734,744)	28%	$34,594,928	6%	$6,859,747	-9%	($7,733,308)
Real Estate	1%	$748,270	1%	$818,037	1%	$682,118	1%	$1,295,777
Retail	16%	$13,539,996	16%	$19,842,334	16%	$18,872,063	15%	$13,768,227
Restaurants & Bars	*1%*	*$590,780*	*1%*	*$894,666*	*1%*	*$1,126,931*	*1%*	*$626,799*
Services	27%	$22,725,836	22%	$26,573,640	28%	$32,629,407	28%	$25,044,661
Transportation	14%	$11,475,949	4%	$4,637,904	6%	$6,863,115	11%	$10,153,992
Utilities & Communications	4%	$3,489,157	4%	$4,601,286	8%	$9,795,189	5%	$4,689,025
Wholesale	16%	$13,088,142	7%	$8,731,189	15%	$17,121,028	25%	$22,581,385
Other Sectors*	0%	$32,066	0%	$158,163	3%	$3,264,538	0%	$271,154
Total		**$83,742,333**		**$122,617,667**		**$116,148,358**		**$89,591,961**
Sub-Sectors Included in Services								
Health Care	*22%*	*$4,975,969*	*19%*	*$5,091,602*	*24%*	*$7,909,935*	*11%*	*$2,771,129*
Oil & Gas Services	*0%*	*$104,918*	*6%*	*$1,553,691*	*4%*	*$1,439,581*	*-7%*	*($1,842,487)*
Tourism	*63%*	*$14,417,502*	*65%*	*$17,379,266*	*61%*	*$19,953,560*	*66%*	*$16,541,776*
Other	*14%*	*$3,227,447*	*10%*	*$2,549,081*	*10%*	*$3,326,331*	*30%*	*$7,574,242*
Total Services		*$22,725,836*		*$26,573,640*		*$32,629,407*		*$25,044,661*
Alaska Native Claims Settlement Act (ANCSA) Corporations (Included in above totals)								
ANCSA Regional Corporations	*33%*	*$2,436,637*	*60%*	*$4,357,329*	*30%*	*$1,916,466*	*-147%*	*($3,296,260)*
ANCSA Village Corporations	*67%*	*$4,956,645*	*40%*	*$2,846,953*	*70%*	*$4,406,303*	*247%*	*$5,533,982*
Total ANCSA Corporations		*$7,393,282*		*$7,204,281*		*$6,322,769*		*$2,237,703*

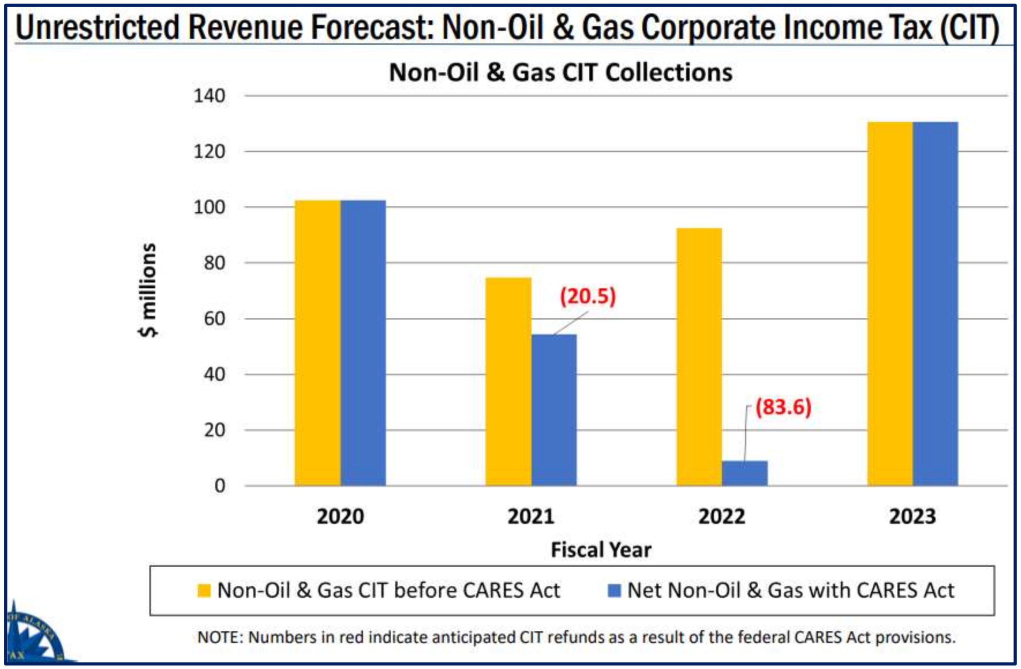
Source: Tax Division Report, Non-Petroleum Corporate Income Tax Collections by Sector

Part 1: CARES Act Carry-Back Issue

- The 2020 CARES Act included a provision for federal corporate taxpayers
  - Any 2018-2020 losses can be carried backwards to a prior tax year
  - Companies could then re-file an older tax return, and potentially get a refund of previously paid taxes
- Alaska has adopted the IRS Code "by reference" unless specifically excepted
  - HB130 creates an exception, de-linking Alaska's corporate income tax from the CARES Act rule
- The Department of Revenue has estimated that the state is liable for about $162 million in tax refunds

Part 1: CARES Act Carry-Back Issue





Source: Department of Revenue, Spring 2021 Revenue Forecast Presentation to House Finance, 3/16/21

Part 1: CARES Act Carry-Back Issue

- The $162 million would reduce the FY2022 deficit by increasing revenue (less "negative revenue" from paying out the refunds)
- However, the long-term impact of this change is revenue neutral
  - Many companies truly did suffer losses in 2020
  - Without this "carry back" provision, they can still carry their losses forward under current law
  - This would reduce their tax payments in a future year, once the company is again profitable
  - Therefore, passage of these sections will likely reduce revenue in and around 2024-2025 by a similar amount

Part 2: Oil and Gas Taxpayer Equitable Treatment

- The corporate income tax is not the production tax.
  These are completely different issues
- Corporate income tax is one of four major petroleum revenue sources
  1. Royalty (landowner share) when production is on state land.
     At least ¼ of royalties go to Permanent Fund
  2. Property (*ad valorum*) Tax on pipeline, equipment, and facilities.
     About 80% of petroleum property tax is credited back to local governments
  3. Production (severance) tax on net profits with a minimum tax "floor"
- Alaska has a long history of treating oil producers different from other companies within the corporate income tax
  - Current "extraction" formula and worldwide apportionment
  - 1978-1981 use of "separate accounting" (Alaska specific profits) rather than apportionment; upheld by Supreme Court

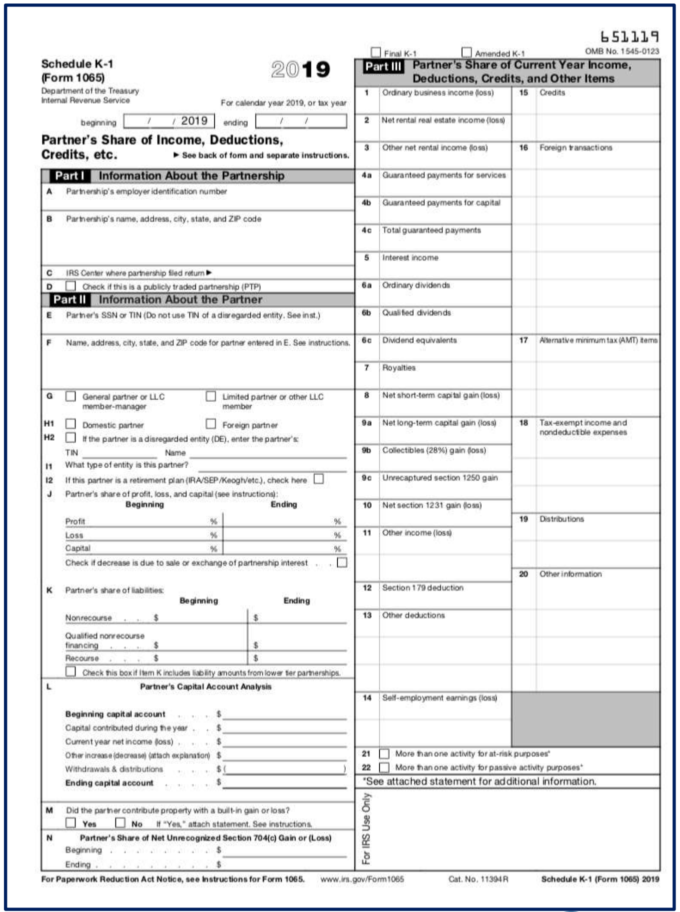
Part 2: Oil and Gas Taxpayer Equitable Treatment

- For most of Alaska's history as a major oil producing state, the vast majority of the production has been from traditional, integrated companies that paid the corporate tax as "C-Corps"
- In recent years, newer, smaller companies have entered Alaska, and some of the older producers have sold their assets
- Currently, about 30% of our oil production is from a company that is organized as something other than a "C-Corporation." Typically, these producers are "S-Corporations"
- HB130 changes the statute so that all oil and gas producers would pay this tax at the same rate

Part 2: Oil and Gas Taxpayer Equitable Treatment

Why aren't these profits being taxed?

- A type S corporation is taxed in the same way as a Partnership or LLC
- They calculate their profits, and file a federal tax return, but their profits are not legally retained by the company.
- Profits are "passed through" to their owners, and taxes are paid via the owners' personal income tax returns
- This works in the federal system, but because Alaska has no individual income tax, these profits are not taxed at all by the State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Final K-1 | Amended K-1 | OMB No. 1545-0123

Schedule K-1 (Form 1065) 2019

Department of the Treasury Internal Revenue Service

For calendar year 2019, or tax year beginning / / 2019 ending / /

Partner's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return ▶

D Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See inst.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G General partner or LLC member-manager | Limited partner or other LLC member

H1 Domestic partner | Foreign partner

H2 If the partner is a disregarded entity (DE), enter the partner's: TIN Name

I1 What type of entity is this partner?

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here

J Partner's share of profit, loss, and capital (see instructions): Beginning Ending

Profit % %

Loss % %

Capital % %

Check if decrease is due to sale or exchange of partnership interest

K Partner's share of liabilities: Beginning Ending

Nonrecourse $ $

Qualified nonrecourse financing $ $

Recourse $ $

Check this box if Item K includes liability amounts from lower tier partnerships.

L Partner's Capital Account Analysis

Beginning capital account $

Capital contributed during the year $

Current year net income (loss) $

Other increase (decrease) (attach explanation) $

Withdrawals & distributions $ ( )

Ending capital account $

M Did the partner contribute property with a built-in gain or loss? Yes No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning $

Ending $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)

2 Net rental real estate income (loss)

3 Other net rental income (loss)

4a Guaranteed payments for services

4b Guaranteed payments for capital

4c Total guaranteed payments

5 Interest income

6a Ordinary dividends

6b Qualified dividends

6c Dividend equivalents

7 Royalties

8 Net short-term capital gain (loss)

9a Net long-term capital gain (loss)

9b Collectibles (28%) gain (loss)

9c Unrecaptured section 1250 gain

10 Net section 1231 gain (loss)

11 Other income (loss)

12 Section 179 deduction

13 Other deductions

14 Self-employment earnings (loss)

15 Credits

16 Foreign transactions

17 Alternative minimum tax (AMT) items

18 Tax-exempt income and nondeductible expenses

19 Distributions

20 Other information

21 More than one activity for at-risk purposes*

22 More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

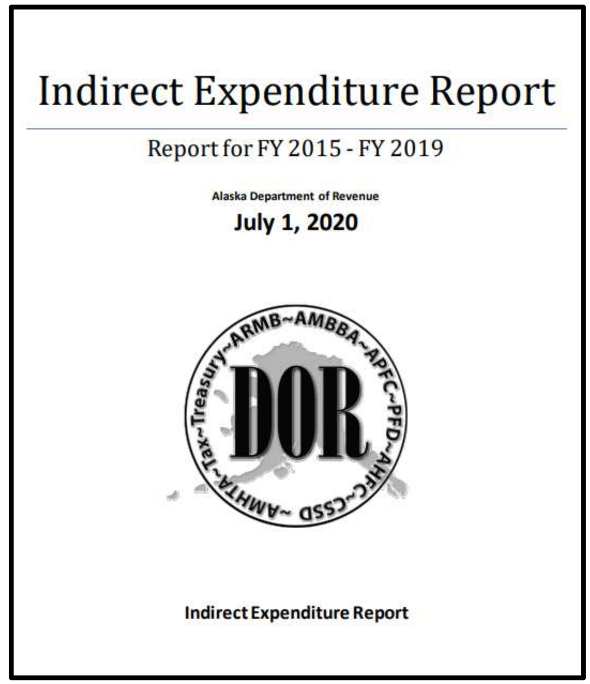
For Paperwork Reduction Act Notice, see Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R Schedule K-1 (Form 1065) 2019

Part 2: Oil and Gas Taxpayer Equitable Treatment

- Although company-specific data is confidential, if the producers are similarly profitable to each other our revenue would be substantially higher
- If the 30% of production owned by non-corporations was taxed at the same rate, average additional revenue for FY2022-FY2030 would be about $50 million / year per the current forecast

Part 3: Corporate Tax Indirect Expenditures

- Alaska statutes have a large number of tax breaks that in some way reduce revenue.
  - These are generally referred to as "Indirect Expenditures"
- The legislature started looking closely at these in 2014, with the passage of HB306 by Rep. Thompson
  - This bill requires periodic reports from both the Legislative Finance Division and the Department of Revenue


Indirect Expenditure Report

Report for FY 2015 - FY 2019

Alaska Department of Revenue

July 1, 2020

Indirect Expenditure Report

Part 3: Corporate Tax Indirect Expenditures

- HB130 addresses two specific "indirect expenditures" identified in these reports
  - Both were previously proposed for elimination in 2018, in HB399 by Rep. Thompson (bill passed the House and died in Senate Finance)

1. Federal Tax Credits that reduce a taxpayer's federal tax liability can be apportioned to Alaska and reduce a company's Alaska tax liability, regardless of whether the credit was in any way related to the company's Alaska activity
   - Example: A company earns a $10 million federal credit for investing in an "opportunity zone" in California. Per HB130, that expenditure would no longer be used in the apportionment of that company's income to Alaska. Depending on the company, our "share" could be a couple hundred thousand.

Part 3: Corporate Tax Indirect Expenditures

2. 80% of Foreign Royalties received by a company are currently excluded from income before it is apportioned to Alaska
   - These are generally royalties for intellectual property, patents, copyrights, etc. Not the resource "royalties" we usually think about here
   - Example: a software company licenses their operating system to a company in Europe. The licensee pays a royalty to the taxpayer based on their sales to customers. Per HB130, those royalty payments would now be fully counted in the income apportionment to Alaska
   - A New York judge recently ruled that foreign royalties could not be excluded, and that requiring taxes to include these payments from non-resident companies was not unconstitutional

Part 3: Corporate Tax Indirect Expenditures

- Together, these two items cost the state an average of $4.0 million / year during the 2015-2018 period (last complete years available)
- In the current Indirect Expenditures report (pages 164-165), DOR said there would be no cost to administer either change if they were eliminated

Fiscal Note Summary

- DOR's Fiscal Note breaks out the revenue by bill component
- Also includes 2 new corporate income tax auditor positions (Total position cost is about $250,000 / year)

(Revenue in $millions)

	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027
CARES Act Carry-Back	$121.4	($17.1)	($7.8)	($11.0)	($13.0)	($7.8)
Oil Taxpayers	$18.5	$46.0	$47.7	$49.4	$51.1	$52.8
Indirect Expenditures	$1.8	$3.7	$3.7	$3.7	$3.7	$3.7
TOTAL	**$141.7**	**$32.6**	**$43.6**	**$42.1**	**$41.8**	**$48.7**

Sectional Analysis

Sec. 1. Amends the definition of who pays the corporate income tax to include other oil and gas business entities regardless of business structure.

Sec. 2 Adds a new definition of "oil and gas business entity," as used in Section 1. This means a person engaged in the production of oil or gas or engaged in the transportation of oil or gas by pipeline in Alaska.

Sec. 3 Limits the use of federal tax credits in the corporate income tax calculation to those credits generated through activities conducted in the state.

Sec. 4 Conforming language to the repeal of AS 43.20.045(b)(3) in Sec. 6.

Sec. 5 Conforming language to the repeal of AS 43.20.045(b)(3) in Sec. 6.

Sec. 6 Repeals the statute allowing 80% of royalties received from foreign corporations to be excluded from the income calculation. Also repeals obsolete provisions related to a former federal tax statute and Stranded Gas Act contracts.

Sec. 7 Adds new uncodified law to sever Alaska's connection to the CARES Act loss carryback provisions.

Sec. 8 Applicability section; the tax changes in this bill apply to taxpayers for years on or after the effective date of the relevant changes.

Sec. 9 Section 7, the CARES Act decoupling, is retroactive to January 1, 2020.

Sec. 10 The effective date for Sections 1-6 is January 1, 2022.

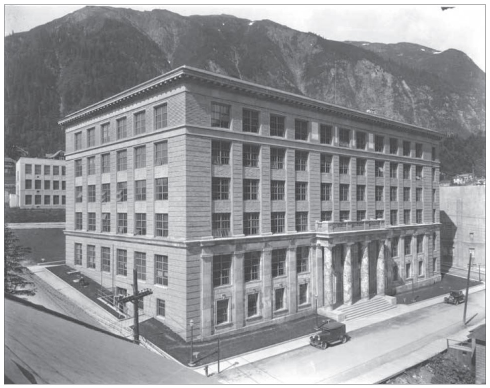
Sec. 11 Except as provided in Sec. 10, the bill has an immediate effective date

Technical Amendment

DOR identified several small issues that could impact implementation. We have submitted a proposed amendment (G.1) to the Chair that would resolve them:

- In the reference to the Federal CARES Act legislation, an incorrect subsection number is used
- Concern that a taxpayer who already re-filed and received a refund for a carry-back loss could have to pay penalties and interest if the bill passes and they must pay back these refunds. Amendment allows for waiver
- Authorizes DOR to write regulations that are retroactive to the effective date of the bill

THANK YOU



Feel Free to Call or Email with Any Questions

Representative Adam Wool
Rep.Adam.Wool@Akleg.Gov
(907) 465-4976