THE STATE of ALASKA
GOVERNOR MIKE DUNLEAVY

Department of Revenue

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October 1, 2021

The Honorable Lyman Hoffman
Alaska State Senator
Co-Facilitator, Comprehensive Fiscal Plan Working Group
State Capitol Room 508
Juneau, AK 99801

The Honorable Jonathan Kreiss-Tomkins
Alaska State Representative
Co-Facilitator, Comprehensive Fiscal Plan Working Group
State Capitol Room 411
Juneau, AK 99801

Dear Co-Facilitators Hoffman and Kreiss-Tomkins,

The purpose of this letter is to provide you with responses to the questions asked of the Department of Revenue (DOR) during our presentation to the Comprehensive Fiscal Plan Working Group on August 5 (items #1-2) and on August 10, 2021 (items #3-8). Please see the questions in italics and our responses immediately below the questions. Thank you for your patience as we took time to research and analyze our responses.

1. ***Provide a version of Slide 5 that presents historical Permanent Fund Dividend amounts in real dollars.***

The chart with historical dividend payments that was on Slide 5, was revised as requested and included in the document presented to the working group on August 10, 2021.

2. ***Provide the most recent oil price futures data available to the Department of Revenue, specifically the oil futures market price for FY 2024.***

The futures market price for FY 2024 as of the morning of July 15, 2021, is $63.59 per barrel which was the same closing price for July 14, 2021. The same data source, Chicago Mercantile Exchange (CME Group) reported the FY 2022 and FY 2023 price forecasts that are represented in DOR's Fiscal Plan Model. This information was also provided during the August 10, 2021, hearing.

3. ***Provide details about which sectors and types of transactions are taxed under the two sales tax options in the Fiscal Model. Also explain how the sales tax figures were estimated.***

DOR modeled two sales tax scenarios – one based on an exemption structure similar to South Dakota's and one based on exemptions similar to Wyoming's. A comparison between the two states is shown in the table below:

Is It Taxed or Exempted?	South Dakota	Wyoming
Clothing	TAXED	TAXED
Groceries	TAXED	EXEMPT
Prepared (Cooked) Food	TAXED	TAXED
Prescription Drugs / Medical Equipment	EXEMPT	EXEMPT
Over the Counter Drugs / Medical Equipment	TAXED	TAXED
Gas / Heating Oil / Electricity	TAXED	TAXED
Business-to-Business Final Purchases	TAXED	TAXED
Business-to Business Purchases for Resale	EXEMPT	EXEMPT
Business-to-Business Services	TAXED	EXEMPT
Services to Consumers	TAXED	TAXED
Oilfield Services	TAXED	*VARIES*

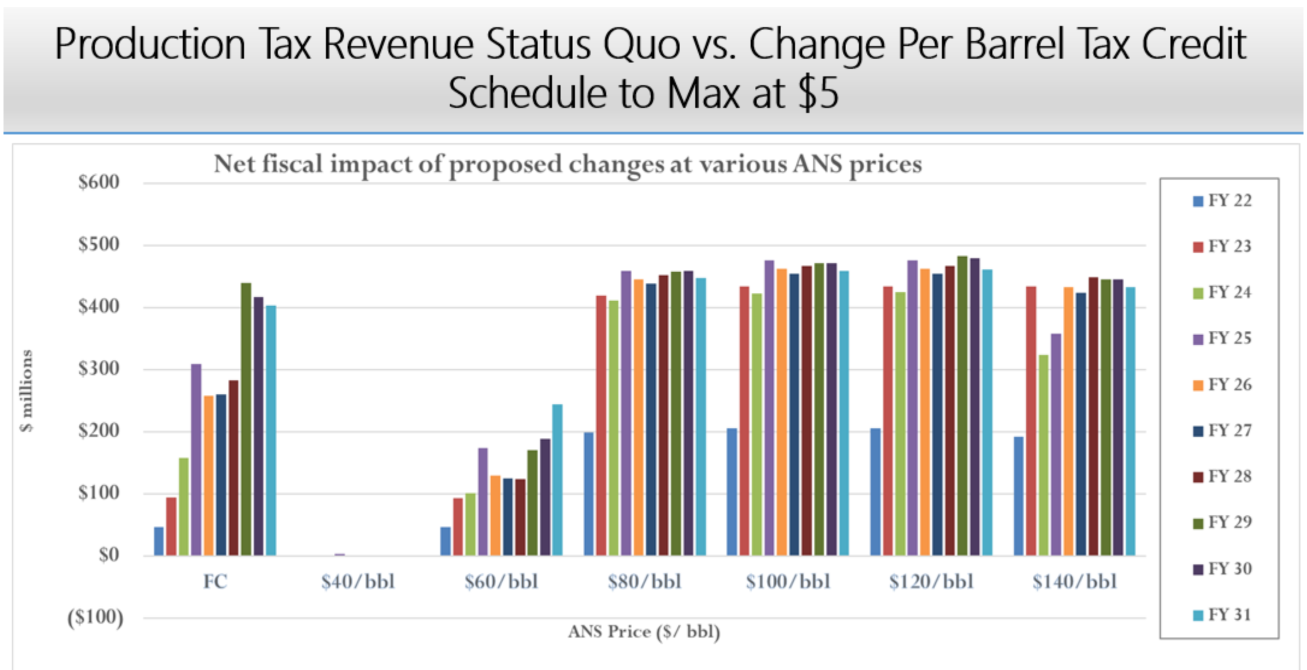
DOR's sales tax model uses 2012 U.S. Economic Census data for NAICS Sectors 44-45 (Retail Trade), 51 (Information), 53 (Real Estate, Rental & Leasing), 56 (Admin Support & Waste Management & Remediation Services), 61 (Educational Services), 71 (Arts, Entertainment, and Recreation), and 81 (Other Services). Sales figures for Sectors 61 (Educational Services), 71 (Arts, Entertainment, and Recreation), and 81 (Other Services) only reflect sales subject to Federal Income Tax. Sales exempt from federal taxation are not included in the model. NAICS Sectors 42 (Wholesale Trade), 48-49 (Transportation & Warehousing), and 54 (Professional, Scientific & Technical Services) are excluded from the model.

The model scales 2012 Economic Census data for offline Alaskan sales to estimated sales for 2017 using the consumer price index and median Alaska household income in the years of interest. The model also scales 2017 estimated U.S. retail e-commerce sales to estimated 2017 Alaska online retail sales using median household income and the number of households in Alaska. Preliminary analysis suggests that if the model was updated to incorporate the most recent Economic Census data our sales tax revenue estimates would be within a similar order of magnitude to the current model.

4. ***Provide estimated fiscal impacts from adjusting the Oil & Gas Per Barrel Credit at a range of price points and also provide information regarding impact on government take.***

DOR analyzed a scenario where the per-taxable-barrel credit for non-Gross Value Reduction eligible production under AS 43.55.014(j) is capped at $5 per barrel, decreasing by $1 per taxable barrel for each $10 increment of wellhead value beginning with a reduction from $5 to $4 per barrel when wellhead value per barrel equals or exceeds $80.

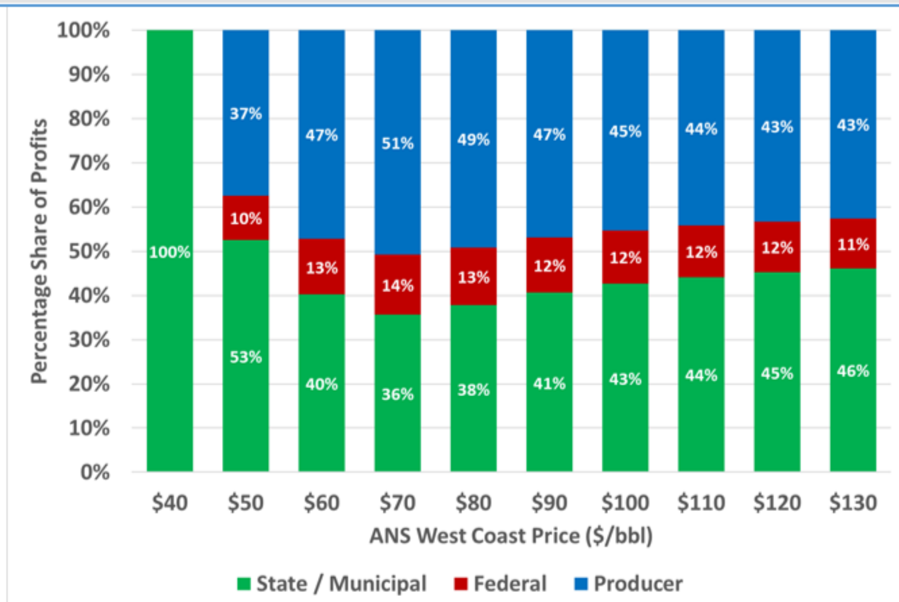
The following chart shows estimated increases to production tax under the Spring 2021 forecast at a range of prices. This analysis holds all other variables constant per the Spring 2021 forecast and does not account for any potential changes in company investment or production as a result of the tax increase. This chart assumes a January 1, 2022, effective date for the tax increase.



All assumptions per Spring 2021 forecast. Tax changes are assumed to take effect January 1, 2022. This analysis assumes a single change to the slide scale per-taxable-barrel credit only. All other provisions of current law, including minimum tax and per-taxable-barrel credit for GVR-eligible production, are assumed not to change. Numbers may not add exactly due to rounding.

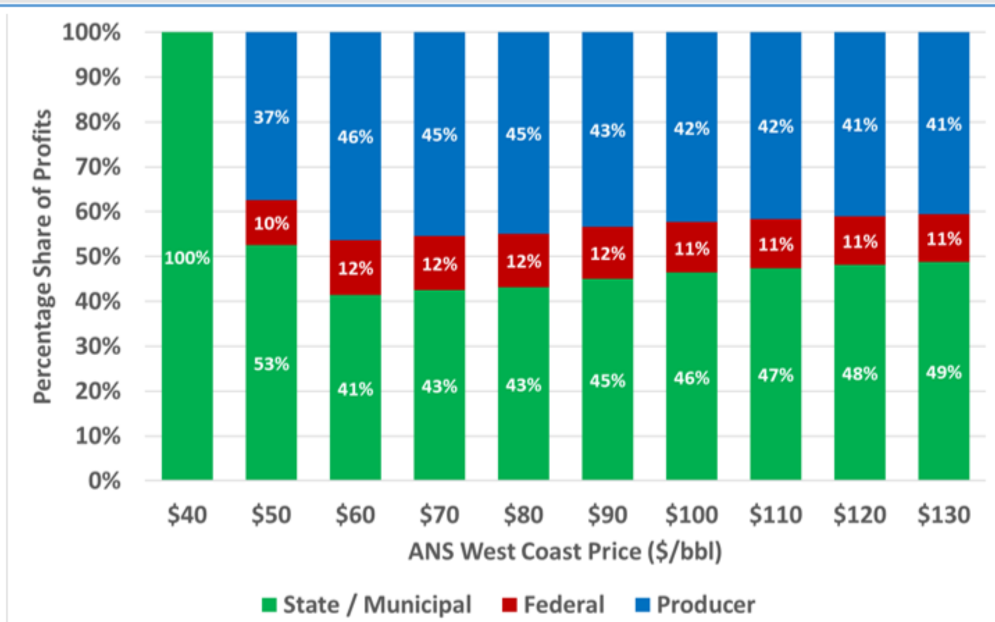
The following two charts estimate the share of profit to producers, state/municipal government, and the federal government at a range of prices under status quo and with a change to per-taxable-barrel credits for typical non-GVR North Slope oil production that flows. These charts are based on Spring 2021 forecast assumptions for FY 2022 and assume that the given fiscal regime is in place for a full year. This analysis makes numerous simplifying assumptions about variables such as corporate income tax, property tax, royalty rate, etc. and does not account for any potential changes in company investment or production as a result of the tax increase.

FY 2022 Share of Profits Sensitivity to Oil Price (Current Tax)



Source: DOR Spring 2021 Forecast for FY 2022. This model is a simplified and aggregated one-year illustration of government take. DOR is in the process of reviewing and analyzing the data on which this is based. Future analyses could have different results. Numbers may not add exactly due to rounding.

FY 2022 Share of Profits Sensitivity to Oil Price (Change Per Barrel Tax Credit Schedule to Max at $5)



Source: DOR Spring 2021 Forecast for FY 2022. This model is a simplified and aggregated one-year illustration of government take. DOR is in the process of reviewing and analyzing the data on which this is based. Future analyses could have different results. Numbers may not add exactly due to rounding.

Increasing production tax revenue from North Slope oil production impacts the profit share amongst state, municipal and federal governments (government take). Reducing the per-taxable-barrel credit lowers the price point at which producers shift from a minimum tax environment to a net tax environment. As the charts indicate, a 3-7% change in government take is seen at oil prices of $60 per barrel and above.

5. **Provide information regarding the draft gaming report from DOR consultants, whether it can be shared and when it could be shared.**

The Department is reviewing the analysis and preliminary recommendations of our gaming consultant, Innovation Group. Once that review is complete and the report is finalized, the administration will share those findings.

6. **Provide an estimated revenue impact for extending the state corporate income tax to all pass-through entities, not just those in the oil and gas industry.**

Per the Department of Commerce, Community, and Economic Development, there were 75,801 entities in good standing in the business license database as of June 30, 2021. There were also nearly 5,400 entities that were non-compliant; these entities may or may not hold a business license in the state. Because these entities are not currently required to report income data to the state, the Department is unable to provide a definitive revenue impact that might result from such a change. However, past analysis estimated that revenue potential at approximately $10-15 million annually for every 1% of tax.

7. **Provide information as to whether other states are pursuing legislation relating to taxation of income of highly digitized businesses.**

Taxation related to the digital economy is starting to change in many states depending on the type of taxes that are currently in place in each state.

The following are examples of how other states and local government jurisdictions are taxing digital goods and services, some of which are related to a sales tax or other taxes already in place.

- Although Arizona voters passed a constitutional amendment banning any type of transactional tax on the sale of intangible property and services, Arizona does have a Transaction Privilege Tax that requires online lodging marketplace businesses to collect the tax.
- Arkansas imposes (1) a Tourism Tax that is levied on the gross receipts derived from the service of furnishing a rental property or room to a transient guest; and (2) a Gross Receipts Tax that is levied on the gross receipts received from the sales of computer software, including prewritten computer software, the service of repairing or

maintaining computer equipment or hardware in any form, the sales of "specified digital products" and digital codes, the service of furnishing rental properties or rooms to transient guests, and the sale of a subscription for digital audio-visual work and digital audio work, pager services, telephone answering services, service contracts, maintenance agreements and extended warranties.

- In California, dozens of cities tax video streaming as a utility user tax (UUT).
- In Illinois, , a 9% amusement tax originally written to tax concert and sporting event tickets was extended to apply to streaming entertainment including music, video, and gaming in Chigaco.
- Colorado has established special rules for television and radio broadcasting income apportionment and requires Enterprise Data Center taxpayers to use a modified sourcing methodology to source sales of services to the state (based on the customer's billing address).
- Connecticut imposes a sales tax on tangible personal property, which includes "digital goods" and computer software.
- The District of Columbia imposes a sales tax on all vendors for the privilege of selling tangible personal property and services, which includes the sale of "digital goods" and the sale of or charges for data processing and information services.
- In Iowa, taxing authorities determined that video streaming services fit the definition of "pay television" and began to assess taxes accordingly.
- Maryland has begun to tax digital advertising gross revenues.
- Tennessee, in contrast, creates a more elaborate approach for taxing most digital goods, carving out pockets of digital products that are free from taxation.
- Texas provides an example of another approach which is based on types of services and states that "the sale or use of a taxable item in electronic form instead of on physical media does not alter the item's tax status".

DOR's proposal is to update Alaska's existing Corporate Income Tax by creating a modified apportionment methodology for highly digitized businesses in an effort to better reflect the way these types of businesses generate taxable income. Instead of using the standard three factor formula (sales, property, and payroll) that most other corporate income tax taxpayers use, highly digitized businesses would use a single sales factor formula. According to the Tax Foundation, over the past few years, many states have increased the weight of the sales factor, with 29 states relying on it completely. While other states that impose Corporate Income Taxes do not have modified apportionment formulas specific to highly digitized businesses (like what DOR is proposing), some have adopted the market based sourcing and other rules (like what DOR is proposing), which captures some of the income generated from digital goods and services. Moreover, this methodology proposed by DOR has been reviewed and supported by the Multistate Tax Compact as well as this Administration's Tax consultant, Joe Crosby.

It is worth noting that Alaska already requires certain industries to use modified apportionment formulas to better reflect the unique ways certain industries generate taxable income. For example, oil and gas taxpayers use a modified apportionment formula consisting of a sales factor, property factor, and extraction factor. Water transportation carriers use a modified apportionment formula where they calculate the sales factor, property factor, and payroll factor using a days-in-port methodology. Airlines use a modified apportionment formula where they calculate the sales factor, property factor, and payroll factor using a ground-time ratio.

DOR's proposal also includes a 10% surcharge for highly digitized businesses, which is intended to be a compensatory tax meant to compensate the state for lost tax revenue that these companies would have otherwise paid the state if they were traditional brick and mortar businesses. Traditional brick and mortar businesses not only pay Alaska Corporate Income Tax, but they also pay a variety of payroll taxes, local property taxes, business registration and license fees, and motor fuel taxes, to name a few. While highly digitized businesses may not be physically present in Alaska *per se*, they still use our local resources. For example, delivery of goods by common carrier burdens our local roads, airports, ports, and fire and law enforcement services. Disputes involving highly digitized businesses burden our court system (debt collection, liens, other contract disputes) and process servers. Warranty services are often performed by local contractors. Product returns can be arranged through local agents (e.g. a highly digitized business may use an unrelated retailer as an agent for product returns). And software downloads and data streaming burden our infrastructure such as network servers, cables, wireless towers, and related personnel to construct and/or maintain facilities/towers.

State and Bill	Type of Tax	Description
Arkansas SB 558	Social Media	7% tax on social media advertising + $1 per AR account
Connecticut HB 5645	Social Media	Unspecified rate of tax on social media advertising (concept bill)
CT Connecticut HB 6187	Digital Advertising	10% tax on advertising revenues for large platforms ($10B global)
Indiana HB 1312	Social Media	7% tax on social media advertising + $1 per IN account
Massachusetts H.2894	Digital Advertising	5% tax on digital advertising revenues ($25M state threshold)
Massachusetts H.3081	Digital Advertising	5-15% tax on digital advertising revenues (low threshold)
Montana HB 363	Digital Advertising	10% tax on digital advertising revenues (low threshold)
New York S.1124	Digital Advertising	2.5-10% tax on digital advertising revenues ($100M global threshold)
New York S.4959	Data (Possession)	5-35 cents per month per New Yorker on which company has data
Texas HB 4467	Digital Advertising	2.5-10% tax on digital advertising revenues (low threshold)
Washington HB 1303	Data (Sale)	1.8% tax on sale of consumer data
West Virginia SB 605	Digital Advertising	2.5-10% tax on digital advertising revenues (low threshold)
State and Passed Legislation	**Type of Tax**	**Description**
Maryland HB 932	Digital Advertising; Digital Products	Special tax (2.5% to 10%) on gross revenues received from digital advertising services; Expanded sales and use tax base to certain digital products and services

Sources: State legislature websites, Tax Foundation

8. Provide a breakdown of assumptions included in the Administration's 10-Year Plan.

Please see the attached table, and note, the only material differences in assumptions between the Administration and the Legislative Finance Division are the school debt reimbursement rate used in FY

2023 – FY 2030 (50% vs 100%); and the rate of inflation (1.5% vs 2.0%). This attachment is our most recent 10-year plan, and we will continue to update it throughout the fall as new information becomes available with final retirement estimates, updated debt figures, and various other items that are collected as part of the annual budget process.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

Sincerely,

lucinda mahoney

Lucinda Mahoney
Department of Revenue
Commissioner

Attachment: 10-year plan detail table for Question #8.