ALASKA STATE LEGISLATURE
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Sponsor Statement
Senate Bill 106

An Act establishing a tax on certain entities producing or transporting oil or gas in the state; and providing for an effective date

In 1958 Congress established the S Corporation (S-Corp) tax classification of the IRS tax code to benefit small businesses and help them stay viable. The S-Corp tax category bypasses income taxes on the entity, enabling tax liability to "pass through" to apply only against the earnings of the individual shareholders. Alaska tax law incorporates the IRS tax code by reference, including taxation of companies. But in 1980 Alaska repealed its personal income tax. This fact results in a glaring anomaly where the state generates tax revenue from the profits of a traditional C Corporation (C-Corp), while an S-Corp that is just as profitable doing business in Alaska gets to avoid paying the state any corporate income tax.

The 2020 sale of BP Alaska, Inc. to Hilcorp Alaska, LLC exposed this latent flaw in Alaska's corporate income tax structure. BP saw great successes in our state for decades, earning major profits from development of Alaska's oil resources. It's been estimated that, as a publicly traded C-Corp, BP contributed up to $60 million in corporate income taxes to Alaska's general fund in recent years. However, Hilcorp Alaska is a registered S-Corp owned by one Texas-based shareholder who now receives all of the profits that BP—an enormous company with thousands of shareholders—had made in Alaska. As a consequence of its S-Corp status and the defect in our tax law, neither Hilcorp nor its owner pay the state any income tax.

It's believed that Hilcorp is already achieving similar profit margins to that of BP in Alaska. But if the problem is not addressed, Alaska will continue to lose substantial tax revenue due to Hilcorp's S-Corp status. In January, the Department of Revenue testified in the Senate Finance Committee that this inconsistency between C-Corp and S-Corp taxation will cost Alaska $80-100 million in tax revenue in fiscal years 2022 and 2023.

The policy rationale and alternate taxing arrangement that led Congress to create the IRS S-Corp classification cannot be met in Alaska. With their profits left untaxed at both the corporate and shareholder level, our own nonpartisan Legislative Finance Division recommends terminating this S-Corp tax exclusion as "these corporations receive the legal benefits of incorporation without any state tax liability." The consequence can only be viewed as an egregious loophole of our tax structure, and there is no sound policy reason not to close it.

SB 106 would fix the state tax code to require non C-Corp entities making significant profits from Alaska's oil and gas resources to pay the same tax rate as C-Corps are required to by law. The new 9.4% tax would apply only to entities making over $4 million in profits from oil and gas production or pipeline transportation, and only to their profits above $4 million.

Declining revenue and extreme deficits since 2014 have forced Alaska to deplete nearly $18 billion in savings and prematurely resort to the earnings of the Permanent Fund. Meanwhile, Alaskans have endured severe cuts to state services and suffered $9,700 in PFD cuts, and the state has forgone needed capital improvement projects.

I urge your support of SB 106. Please join me in closing this egregious and unnecessary tax loophole.

Revised 2/16/22

Distributed by Senator Bill Wielechowski
SB 106 - Senate Resources Committee 5/4/22

BP pullout could affect state revenue

By Sean Maguire | Posted: Wed 7:12 PM, Aug 28, 2019 | Updated: Wed 8:42 PM, Aug 28, 2019

ANCHORAGE (KTUU) - Same oil field, different tax structure.

When Hilcorp starts operating Prudhoe Bay, the State of Alaska could miss out on tens of millions of dollars of revenue as the company will not pay the corporate net income tax. Oil industry representatives say increasing production could bridge that fiscal gap.

Hilcorp, a privately owned company, is an S Corporation, meaning it is exempt from paying the tax. Prior to 1980 when the Alaska Individual Income Tax was in place, private business owners paid their company's taxes at the individual rate as pass-through income.

When the individual income tax was eliminated, taxing pass-through income was also eliminated. Former Democratic Rep. Les Gara introduced legislation in 2017 that would have closed that so-called loophole for high profit companies.

As a publicly traded company, BP Alaska is classified as a C-Corporation, meaning it pays the corporate net income tax annually. How much it pays is confidential information that the Department of Revenue will not disclose publicly.

Meg Baldino, a spokesperson for BP Alaska, would also not disclose how much the company paid under the corporate net income tax but she did say that overall, "BP Alaska paid $804 million in taxes and royalties to the State of Alaska in 2018."

According to Gara's best estimate, the company is likely paying between $25-$60 million per year to the state under the corporate net income tax.

"You shouldn't be exempted from it just based on the form of your corporation, like Hilcorp gets exempted, when it's going to own the same fields that BP owned. It makes no sense," he said, before describing that the loss in revenue would likely impact state services.

The company net income tax is one of four taxes and royalties paid to the State of Alaska by oil companies. It is also the smallest tax levied on them compared to royalties, property taxes, and production taxes.

Alaska Oil and Gas Association President and CEO Kara Moriarty suggests private oil companies may have been exempted from the tax to entice new investment. "And that happened, we got new investment to Alaska," she said.

She also says that the focus for the State of Alaska should be increasing production as the bulk of its oil revenue comes from production taxes and royalties. "The more you're producing, the more you're going to have for the state in the long-term."

Hilcorp aims to do just that at Prudhoe Bay.

"At Hilcorp we are first in class at injecting new life into existing fields. This is why we purchased these assets," read a prepared statement from Hilcorp spokesperson Justin Furnace. "We will be working to evaluate new opportunities at Prudhoe, but this process will take many months. Our current focus is transition of the current assets to Hilcorp ownership and operation and the employees and contractors that may be affected by the change."

Furnace did not answer emailed questions as to whether the current tax exemption enticed the company to buy BP Alaska's assets.

Sen. Bill Wielechowski, D-Anchorage, a long-time proponent of increasing Alaska's oil taxes, says the Legislature should examine how the corporate net income tax is implemented. Both Gara and Wielechowski are part of an unrelated ballot initiative that seeks to increase taxes on major oil companies.

Industry analyst Larry Persily believes lawmakers will seek to hear from Hilcorp representatives directly and hold hearings on the corporate net income tax. But he's not sure it will change anything.

"Whether there's the votes to change it, I wouldn't bet on it," he said.

SB 114

Oil Revenue Reform Bill

Presentation to Senate Finance Committee – March 31, 2023

"The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people."

-Article 8, Section 2, Constitution of Alaska

SB 114: Three Common Sense Reforms

Closes Income Tax Loophole for Highly Profitable Petroleum Business S-Corps

Reduces the Sliding Scale Per-Barrel Credits & Requires Investment Match

Ringfences Losses on Alaska's Most Profitable North Slope Fields

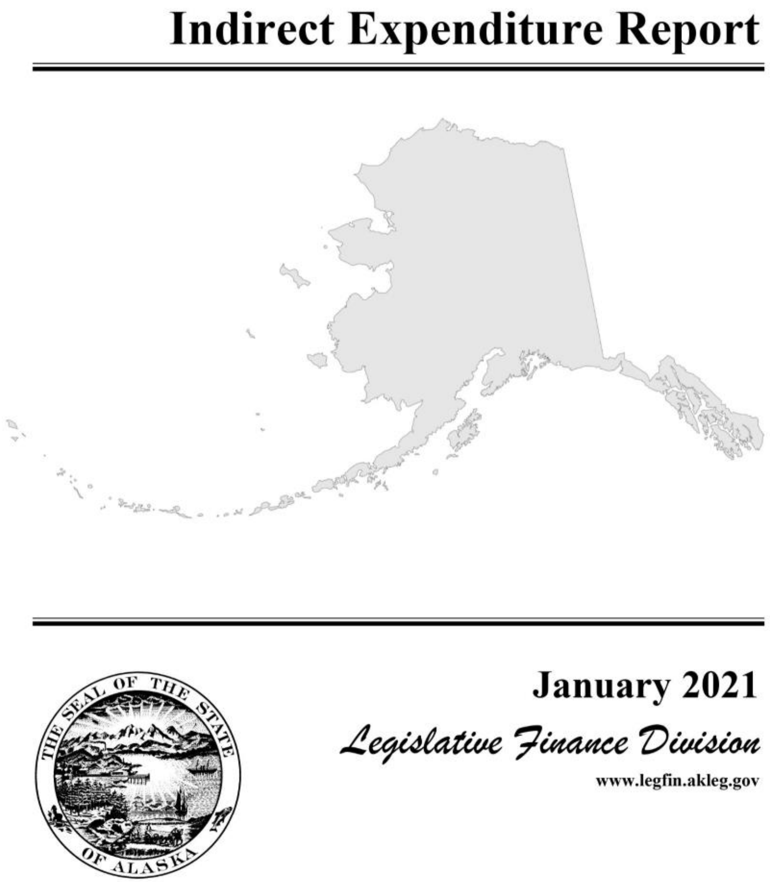
Closing the S-Corporation Tax Loophole

“S Corporation” stands for “Subchapter S corporation”, or sometimes “Small Business Corporation." It is a special tax status granted by the Internal Revenue Service that lets corporations pass their corporate income, credits and deductions through to their shareholders.

The S-Corp Loophole

- Alaska incorporates the federal Internal Revenue Code as its tax code.
- The IRS taxes "pass-through" entities like privately owned S-Corps at the owner level to ensure taxes are collected on profits.
- But in 1980 Alaska repealed the personal income tax with HB 1040.
- This created a loophole for S-Corps to avoid paying taxes in Alaska, unlike regular public Corporations.

The Nonpartisan Legislative Finance Division Recommends Closing this Loophole


Indirect Expenditure Report

January 2021

Legislative Finance Division

www.legfin.akleg.gov

“Should it be Continued, Modified, or Terminated?”

“Recommend termination. "S" corporations are exempt from the federal corporate income tax because income from these corporations is taxed under the personal income tax. Without a state personal income tax, these corporations receive the legal benefits of incorporation without any state tax liability.”

-Indirect Expenditure Report, January 2021, Page 144

The Department of Revenue Presented this Concern to the Legislative Fiscal Policy Working Group in 2021

Existing Revenue: Expand Corporate Income Tax to Oil and Gas Pass-through Entities

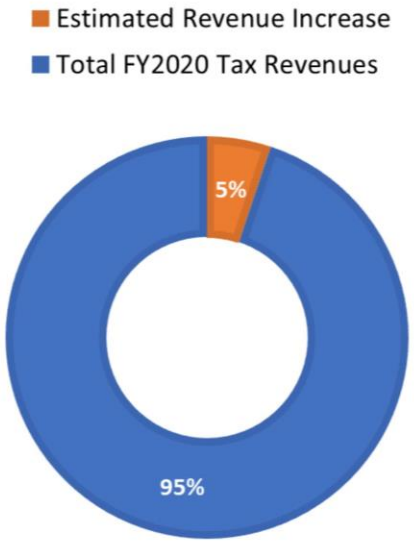
Description: This option proposes to tax oil and gas pass-through entities at the same rate as the current Corporate Income Tax on C-Corporations. This option defines "entities" to mean sole proprietorships, partnerships, and S-Corporations. This option would apply to any business who files a return, claim for credit or report under AS 43.55 (oil and gas production tax).

First Full Year Impact: $67.1 million in FY 2022

Using our July 2021 ANS price update as the basis, the estimate is that this could increase corporate income revenue by $47 to $61 million per year from FY 2022 to FY 2030. The FY 2022 estimate includes retroactive application to 1/1/2021. The range is due to forecasted changes in production, oil prices, and anticipated company profitability this period.

Costs: There are no incremental costs to implement this change.

OIL & GAS PASS-THROUGH ENTITIES CORPORATE INCOME TAX



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Source: "Comprehensive Fiscal Policy Plan for Alaska" presented by Commissioner Lucinda Mahoney August 10, 2021

Now is the Time to Close this Loophole

The Department of Revenue estimated that over just FY22 and FY23, Alaska will have lost $194 million in revenue due to this defect.

Source: Fiscal Note SB 106-DOR-TAX-4-29-22, 32nd Alaska State Legislature

The SB 114 Solution

Closing this Loophole Levels the Playing Field Between Privately Owned S-Corps and Public C-Corporations

Applies only to oil & gas production or pipeline transportation pass-through entities

9.4% Tax rate that matches percent tax on Alaska's highest tax bracket for C-Corps

Applies only to profits over $4 million

Alaska’s S-Corp Shareholders will Receive Federal Tax Benefits

The owners of an S-Corp pay federal income taxes as individuals. If they are high income earners, they likely pay at the top marginal tax rate of 37%.

Since the amount of taxes they pay to Alaska is deductible from their federal taxable income, their taxes due to the IRS will be reduced by 37% under this provision.

State of Alaska
Comprehensive Fiscal and Policy Plan for Alaska

Legislative Fiscal Policy Working Group
Updated August 10, 2021

Department of Revenue
Lucinda Mahoney, Commissioner

Governor
MIKE DUNLEAVY

Fiscal Options for Consideration

Revenue Options*

A. Modify maximum sliding scale per barrel credit from $8.00 to $5.00.
B. Require Oil & Gas pass-through entities to pay Corporate Income Tax (CIT)
C. Implement a broad-based sales tax
D. Establish legalized gambling in our State: Internet gaming, lottery, and casinos
E. Modernize CIT statutes to include highly digitized businesses
F. Generate revenues by monetizing our carbon offsets
G. Increase motor fuel tax, excluding aviation
H. Use of Federal Funds for revenue replacement
I. Draw from the ERA as a Bridge/Transition fund
J. Other ideas from Legislature/Administration/Public

* Detailed descriptions in the appendix of this presentation

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