

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

February 27, 2006

9:02 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Norman Rokeberg
Representative Paul Seaton
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Ralph Samuels

COMMITTEE CALENDAR

HOUSE BILL NO. 418

"An Act relating to a mining production tax; relating to the mining license tax; relating to production royalties on minerals; relating to exploration incentive credits; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 418

SHORT TITLE: MINING PROD. & LICENSE TAXES/ROYALTIES

SPONSOR(S): REPRESENTATIVE(S) SEATON

02/01/06	(H)	READ THE FIRST TIME - REFERRALS
02/01/06	(H)	W&M, RES, FIN
02/22/06	(H)	W&M AT 9:00 AM CAPITOL 106
02/22/06	(H)	Heard & Held
02/22/06	(H)	MINUTE(W&M)
02/24/06	(H)	W&M AT 9:00 AM CAPITOL 106
02/24/06	(H)	Heard & Held
02/24/06	(H)	MINUTE(W&M)
02/27/06	(H)	W&M AT 9:00 AM CAPITOL 106

WITNESS REGISTER

STEVE BORELL, P.E., Executive Director

Alaska Miners Association, Inc.

Anchorage, Alaska

POSITION STATEMENT: Spoke in opposition to HB 418.

RICH HEIG, Vice President

Council of Alaska Producers (CAP);

General Manager

Greens Creek Mining Company

Juneau, Alaska

POSITION STATEMENT: Spoke in opposition to HB 418.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [9:02:11 AM](#). Representatives Weyhrauch, Moses, Seaton, and Wilson were present at the call to order. Representatives Gruenberg and Rokeberg arrived as the meeting was in progress.

HB 418-MINING PROD. & LICENSE TAXES/ROYALTIES

[9:02:18 AM](#)

CHAIR WEYHRAUCH announced that the only order of business would be HOUSE BILL NO. 418, "An Act relating to a mining production tax; relating to the mining license tax; relating to production royalties on minerals; relating to exploration incentive credits; and providing for an effective date."

[9:02:44 AM](#)

STEVE BORELL, P.E., Executive Director, Alaska Miners Association, Inc., recapped his testimony from the previous hearing on HB 418 saying that the administration and past legislation led those in the mining industry to believe "[Alaska] is open for business." Many companies responded, he noted, by investing in Alaska at a time when metal prices were low. By 2004, the metal prices began to rise such that today all precious metals, base metals, and coal prices are at elevated levels - "the first time that this has ever happened," he said. He expressed that whereas the mining industry has appreciated the past efforts of the administration to improve business viability in the state, it "clearly does not support this legislation" Referring to comparisons made at the prior meeting between the mining and fishing industry, he said that it is "not fair" to compare the two. He observed that both industries do have a need for people and mobile equipment;

however, "beyond that, many of the things do not compare." He relayed that the mining industry, unlike the fishing industry, involves many requirements and expenses such as: the baseline environmental studies and environmental impact statements (EIS) that often last 3 or more years; the approximately 50 different state and federal permits with the expense born by the company itself; the guaranteed "pay-back" for use of state-built port facilities, such as the one at the Red Dog Mine, which cost the state \$105 million to build and for which the mine owners have paid back \$208 million to date on the loan; and the building of roads, electrical power plants, and processing plants, all paid up front by mining companies before receiving any returns.

MR. BORELL then referred to prior comparisons made to mining industries in other countries such as Canada where roads, railroads, power plants, and even cities were built and paid for by the Canadian government to provide jobs and infrastructure for the timber and mining industries. He returned to a previous discussion regarding foreign companies and foreign ownership in Alaska and, in citing many examples of such in operation said, "It's hard to understand why anyone would want to criticize foreign investment in Alaska." In conclusion, he opined:

We believe that passage of this bill, even out of this one committee, would be an extremely bad thing. It would not be understood by the industry, and it would have a negative effect ... and it would be bantered about in other jurisdictions as "look ... Alaska just changed the law on taxation; they turned it upside down after 20 plus years of stability, and now they've pulled the rug out from under the companies." So with that, we urge that this committee not pass this bill.

[9:16:55 AM](#)

REPRESENTATIVE ROKEBERG asked Mr. Borell whether he perceives moving HB 418 out of committee as "a positive pro-tax action by a legislative body."

MR. BORELL said that he would. He informed the committee that the [mining industry in Alaska] is currently in extreme competition with British Columbia (BC). He explained that BC has pass-through taxation such that a BC resident investing in a mining company, which in turn invests its operations in BC, treats that investment as an expense on his/her taxes - a benefit not possible for Canadians when investing in companies

in Alaska who would likely be further discouraged by the change in mining taxation proposed in HB 418.

9:18:55 AM

REPRESENTATIVE WILSON sought confirmation of her understanding that most companies are able to deduct expenses and most don't see a profit for several years, and asked Mr. Borell to compare this between those businesses in Alaska and Canada.

MR. BORELL clarified that he is referring to the individuals, not the companies, and the tax deductions they are allowed to make when investing in Canadian companies. This flow-through benefit would not be applicable in Alaska due to there being no personal income tax for residents in this state, he explained. In further response to questions, he said it was to BC residents' personal advantage to see their money invested within BC rather than outside the province. He highlighted that this "flow-through" investment advantage is also available on a national level in Canada as well. However, he mentioned that he was not familiar with the specifics of either benefit.

REPRESENTATIVE SEATON sought confirmation that Mr. Borell was referring specifically to Canadian [investors], not investors worldwide.

MR. BORELL said he believed this is correct.

REPRESENTATIVE SEATON then asked Mr. Borell whether the companies interested in allowing those investors are leaning toward using a Limited Liability Company ("LLC") or S corporations in Alaska "so that they do pass the taxes through and so that they're not paid in Alaska."

MR. BORELL said he did not know.

9:22:51 AM

REPRESENTATIVE GRUENBERG suggested that those Canadian investors allowed to take deductions on their income tax could be "lured" to Alaska where no state income tax is paid.

MR. BORELL specified that he is referring to investors, not individual workers, and added that the industry "does everything it can to find those Alaskans [seeking employment] and put them to work, especially in their local communities." In response to questions by Representative Wilson, he recalled that according

to a recent study by the Canadian Consulate, over 50 percent of the different mining investments in Alaska are Canadian. He opined that the United States (U.S.) has "basically run the mining industry out over the past couple decades" due in part to federal mining laws; the extremely stringent, often punitive, environmental requirements; and the trend in consolidation of some of the U.S. mines by foreign companies, such as the purchase of the Homestake Mining Company in South Dakota by the Canadian mining company, Barrick Gold Corporation. He concluded that "we just don't have the investments coming to the United States that we did at one time."

[9:25:21 AM](#)

REPRESENTATIVE SEATON asked Mr. Borell to compare the difference between the net smelter return (NSR) rates currently paid by those companies mining on private lands - such as the Fort Knox Mine on the Mental Health Trust lands and the Red Dog Mine on Native corporation lands - to the tax Alaska receives from those mines operating on state land.

[9:26:25 AM](#)

MR. BORELL replied that he did not know what these rates would be, and furthermore was not certain how a comparison could be made. He reminded the committee that there are only five large mines in the state: Usibelli Coal Mine, Inc., Greens Creek Mine, Red Dog Mine, Fort Knox Mine, and the Pogo Mine Project. He highlighted that the Pogo Mine Project is the first mine being operated purely on state land.

REPRESENTATIVE SEATON explained that the purpose of this bill is to assure a reasonable return. Prior testimony has been heard indicating that "a net smelter return royalty rate will kill every mine in Alaska," he said, and "it's got to be [maintained at] 100 percent of the net." However, he indicated that those big mines developed recently on private lands have paid higher NSR rates than those proposed in HB 418. He sought clarification as to why those companies are willing to pay the higher rate on private land and not on state land.

MR. BORELL said he has not heard it said that "an NSR would kill all the mines in Alaska." He said he "presumed" Red Dog Mine has an NSR, however, noted that neither the Greens Creek Mine, the Fort Knox Mine, nor the Pogo Mine Project have an NSR. He stated that he was "at a loss to know which mines are on private land that have negotiated an NSR." In response to Chair

Weyhrauch, Mr. Borell confirmed that the Pogo Mine Project is on state lands. In regard to whether there are any distinctions between the tax rate that's assessed against a mine and the lands on which they operate, he explained that the Mining License Tax is the same for every operation irrespective of the land ownership. He noted that the production royalty is strictly against state land, however, as well as payment of rent, which escalates over time.

[9:31:25 AM](#)

REPRESENTATIVE WILSON requested Mr. Borell repeat his explanation of which mines are on which lands.

MR. BORELL clarified that Red Dog Mine is on NANA Regional Corporation lands owned by Alaska Natives of the Northwest Arctic, Greens Creek Mine is on federal land and private lands, Fort Knox Mine is on Mental Health Trust lands, Pogo Mine Project is on state land, and Usibelli Coal Mine, Inc. is on state land. He highlighted that these are the only 5 mines in Alaska and they employ over 100 employees.

CHAIR WEYHRAUCH asked if there is a distinction between exploration and development.

MR. BORELL said that although various jurisdictions in the world would interpret this differently, in Alaska development begins once the construction of facilities begins. In further response to questions, he explained that "the break point," is clearly defined under the Mining License Tax as the point at which a company has all its permits in place to start [development]. He remarked that "if you can jump through all the hoops to get your permits, you're very pleased to start construction, typically."

CHAIR WEYHRAUCH sought confirmation of his understanding that the most expensive part [of the mining business] is exploration during which companies typically go through a permitting process, perform studies and environmental analysis, address litigation, perform infrastructure development, and transport gear to the site.

MR. BORELL commented that the aforementioned explanation is slightly mixed between exploration and development. He exemplified Kensington Mine, which prior to construction had a camp in place, a road to the site, an adit driven into a mountain, entries developed off the adit to obtain bulk sampling - all of these steps taken before it was determined to be economic to

build the mine and go forward. "That's when the development starts," he explained. Furthermore, all permits have to be in place to make that decision.

CHAIR WEYHRAUCH asked if there was a point at which the company could say, "We're not in exploration anymore, incurring those costs and overhead; we're in construction and development." He noted that Kensington Mine does not have all its permits, such as Section 404 of the Clean Water Act (CWA), yet it is constructing.

MR. BORELL explained that Kensington Mine did have that permit at one time but it was withdrawn and [development] was stopped. He said that the company did not start construction of its facilities until all permits were acquired.

[9:35:41 AM](#)

REPRESENTATIVE SEATON informed the committee that neither the current mining tax nor the proposed tax differentiates between exploration and construction. The proposed tax is applied after construction starts, at the time of production.

MR. BORELL said his understanding of the bill is that it focuses on production and not on exploration and construction, "except for the piece that removes the investment incentive."

REPRESENTATIVE SEATON informed the committee that the portion of the bill addressing investment incentives is under Section 15.

MR. BORELL opined that the investment incentive has done "exactly what we hoped it would and what ... the legislature hoped it would." He said during discussions with former governor Tony Knowles, there were questions raised as to the possibility that providing [investment incentives to the mining companies] would "strip out any revenues that the state was ever going to get from mining." He relayed that his response to this was that it would be many years before any project could potentially receive a benefit from the proposed incentive. In fact, he expressed his belief that no company within the last 10 years has been able to take advantage of and receive a benefit from this exploration incentive. More than anything, he opined that the benefit is more of an encouragement to companies and to "stop it now is very, very wrong."

[9:38:44 AM](#)

REPRESENTATIVE ROKEBERG asked how long it takes a mining company to obtain state and federal permits to bring a project online. Additionally, he asked Mr. Borell to comment on the failure rate of earlier mining projects in Juneau and surrounding areas.

MR. BORELL relayed that it took Pogo Mine three years and one month to go through the permitting process which was considered to be a "fast process." Kensington Mines, however, has been through the EIS process three times, with the initial process taking over two years, he said. By the time it was completed, he explained, the price of gold had decreased such that the project was no longer economic. The company then went through two more lengthy periods of completing the required supplemental EISs for each period - the first of which was completed just when the price of metal had decreased again and the completion of the second was followed by the closure of the mine.

[9:42:39 AM](#)

CHAIR WEYHRAUCH sought clarification on earlier testimony attesting that no exploration credits have been used to date.

MR. BORELL suggested that more information could be provided by the Division of Mining, Land and Water in the Department of Natural Resources (DNR). He said to his knowledge, there have been companies which were certified, however, none that have ever been able to apply exploration credits to taxes owed.

REPRESENTATIVE SEATON, in response to a question by Chair Weyhrauch, explained that "the exploration credits were against the Mining License Tax and ... since the Mining License Tax was repealed, then everything that applied to the Mining License Tax no longer applied." However, he informed the committee that it was his understanding that those companies previously certified would still "under law" be able to apply the credit.

REPRESENTATIVE ROKEBERG questioned whether this would hold true when a law is repealed. He then commented on the lengthy periods of time for the Pogo and Kensington mine developments, and asked whether Mr. Borell could provide the committee with a more precise estimate on the amount of time required to establish a mine to the point it's "sanctioned for investment."

MR. BORELL explained that the years to which he referred for both these mines were for the period of time each company was working on environmental impact statements. He added that there are many years before the completion of the environmental impact

process and during which mining companies spend considerable lengths of time exploring, designing, and evaluating the scope of the project and time involved.

REPRESENTATIVE ROKEBERG expressed concern for the considerable amount of time and effort the legislature has spent in the last decade in creating the exploration credit taxes in addition to the expense of providing geophysical aerial mapping "to enhance the investment and development of the mining industry in Alaska." He relayed that if he could see any substantive progress in "narrowing this window of development [to a more reasonable time frame] so it would have a net present value positive on investment and jobs in this state, [he] might be more amenable to looking at the government-take situation [as proposed in HB 418]."

9:46:41 AM

REPRESENTATIVE WILSON asked Mr. Borell whether the fact that companies have not yet taken advantage of the incentives tax is because they haven't made sufficient profits to do so. She also inquired as to whether profitability was impacted by which lands were involved - Mental Health Trust Lands, Native lands, or state lands.

MR. BORELL said he did not know the answer to the latter question. To the first question, he explained that the reason "no tax has been taken" is that no [mining] project has progressed far enough to be in operation and to then [apply] a credit. He expressed his belief that Pogo Mine, newly in production, will be the first to do so, and Usibelli Coal Mine, Inc. is close to taking the credit as well. He clarified that the investment incentive credit can be applied against the Mining License Tax, state royalties if the operation is on state land, or a corporate income tax. However, he relayed that if a company is not in operation, there is no way it can take the credit, and furthermore the credit can be applied to no more than 50 percent of the required tax. He opined that the incentive credit program was "an extremely well thought-through process."

REPRESENTATIVE WILSON restated her question as to whether "who owns the land" makes a difference to mining companies and how much of a difference.

MR. BORELL said he was not certain of the answer. However, he highlighted that during former president Bill Clinton's

administration, no one explored on federal land and only recently has such been considered. He relayed that there are many reasons beyond the required royalties that affect consideration of where to mine, such as political stability or the cost and value of [the available minerals].

[9:52:07 AM](#)

REPRESENTATIVE SEATON, referring to Table 2 of the "Revenue Collections Detail," directed the committee's attention to the \$2,568 entry for "Alaska education credit" and the \$29,736 entry for "mineral exploration incentive credit" in fiscal year 2003 (FY 03). He then referred to a previous committee hearing on HB 418 when Rick Van Nieuwenhuysse of NovaGold Resources, Inc. testified that one of the differences between mining in Alaska and British Columbia (BC) is the higher energy costs in this state. Representative Seaton questioned whether the proposed installation of a [power] line to run from the Four Dam Pool hydroelectric project in Alaska to BC, should move forward. In light of comments made that those operating in Alaska, as opposed to BC, could not expect a reasonable return with any increase to taxes because of the already high electric costs, he pointed out that this power line would provide electricity to BC at possibly higher rates than those charged in Alaska.

MR. BORELL said he did not know the economics to this, though he suggested that "the incremental cost of selling that power is probably pretty miniscule" and it could possibly provide "low-priced power."

REPRESENTATIVE WILSON relayed that everyone connected to that power grid in her district and "clear up into South Central" will have lower electrical prices.

REPRESENTATIVE SEATON clarified that his previous comment was made in an attempt to create more discussion on his observation that the reason why the [mining industry] tax structure in Alaska can't be equivalent to Canada's is due to the fact that Canada provides infrastructure and power to its industry whereas Alaska, with its lower tax rates, [must] charge more for power.

[9:56:43 AM](#)

RICH HEIG, Vice President, Council of Alaska Producers (CAP); General Manager, Greens Creek Mining Company, said he wished to clarify for the record that he did not hear Mr. Van Nieuwenhuysse say that "any NSR tax will kill the mining industry in the

state." He said he would like to comment from the investor's perspective. When his company is considering where to invest, he explained, it models the life of the mine for x-number of years and figures in a range of costs from production, operating costs, capital costs, smelting and refining charges, and all applicable taxes. An NSR tax, he said, reduces the net income and "raises the hurdle for a project to be developed." Additionally, with a drop in metal prices, an NSR tax makes the project more difficult to be approved from an investment standpoint, he opined, and is viewed as "a regressive tax" - a definite factor in evaluating a project. Regarding the fair market value appraisals on federal lands, he relayed that the Greens Creek Mining Company has a net island return on some parts of its federal lands. This type of return, he explained, is similar to an NSR; however, it's based on varying metal prices where lower metal prices lower the tax and higher ones raise the tax. He relayed that his company is currently considering other properties on federal lands - lands which are viewed as a "negotiated item" at fair market value of the property and potential minerals paid for up front at an "NSR type return." However, he said that it is his company's intent to "steer away" from NSRs in negotiating on federal lands.

[10:01:44 AM](#)

REPRESENTATIVE SEATON sought confirmation of his understanding that an NSR is applied to minerals after they have been processed and are ready for shipment.

MR. HEIG said he does not understand the use of the term "net smelter return" as it's described in the bill. He clarified that the NSR with which he is familiar begins at the point at which the product is ready for transportation.

REPRESENTATIVE SEATON referred to mine mouth value addressed in HB 418, which allows a company to subtract ball mills and other on-site processing costs in addition to the deductions allowed under an NSR. He then asked if the mine mouth value were to include the deduction of costs for the preparation of ore for shipment, would it be perceived as advantageous [by investors] or less attractive than an NSR.

MR. HEIG expressed his belief that it would be more attractive and "more advantageous from the standpoint of a net smelter return that starts at transportation, but it's still a pre-tax versus post-tax calculation." In response to questions by Representative Rokeberg, Mr. Heig explained that "net island

return" is the term used between Greens Creek Mining Company and the U.S. Forest Service. As far as there being any parameters determined by federal law or regulation to guide the negotiation process, he said he was not involved when the net island return was negotiated between the company and the U.S. Forest Service. He clarified that his company is currently negotiating other projects on federal lands in other states and said he perceives it to be a "negotiating item that benefits both parties as best as possible."

REPRESENTATIVE ROKEBERG asked if it would be fair to say that there is some flexibility in a private company's dealings with the federal government.

MR. HEIG said he believed this to be correct.

REPRESENTATIVE SEATON asked whether there is "a federal royalty paid on the main portion of Greens Creek."

MR. HEIG said there was not.

[HB 418 was held over.]

[10:05:01 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:05 a.m.