

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

March 1, 2006

9:06 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Paul Seaton
Representative Peggy Wilson
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg
Representative Ralph Samuels
Representative Max Gruenberg

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
02/27/06	(H)	Heard & Held
02/27/06	(H)	MINUTE(W&M)
03/01/06	(H)	W&M AT 9:00 AM CAPITOL 106

WITNESS REGISTER

DAN STICKEL, Economist
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Explained the revenue side of the DOR fiscal note for HB 418.

JOHANNA BALES, Excise Audit Manager
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Explained the expense side of the DOR fiscal note for HB 418.

KERWIN KRAUSE, Mineral Property Manager
Division of Mining, Land and Water
Department of Natural Resources (DNR)
Anchorage, Alaska
POSITION STATEMENT: Provided information on the possible impacts of HB 418.

ED FOGELS, Acting Deputy Commissioner
Department of Natural Resources (DNR)
Anchorage, Alaska
POSITION STATEMENT: Provided comments on HB 418.

DICK MYLIUS, Director
Division of Mining, Land and Water
Department of Natural Resources (DNR)
Anchorage, Alaska
POSITION STATEMENT: Explained the effect HB 418 would have on DNR.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [9:06:06 AM](#). Representatives Weyhrauch, Moses, and Seaton, were present at the call to order. Representative Wilson arrived as the meeting was in progress.

HB 418-MINING PROD. & LICENSE TAXES/ROYALTIES

[9:07:25 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."

9:07:51 AM

DAN STICKEL, Economist, Tax Division, Department of Revenue (DOR), in response to Chair Weyhrauch, said he was not aware of DOR having any official position on the bill.

CHAIR WEYHRAUCH directed the committee's attention to the "March 1, 2006" fiscal note prepared by the DOR Tax Division and requested Mr. Stickel explain the note.

9:09:46 AM

MR. STICKEL, relayed that he prepared the revenue side of fiscal note and Johanna Bales, Excise Audit Manager of the Tax Division, prepared the expenses side of the note. He explained that the bill would eliminate the existing Mining License Tax and replace it with a production-based tax. He then referred to the two steps used for estimating the revenue impact of the bill: the first being an estimation of the revenue realized under the current tax system, and the second being an estimation of the revenue under the [proposed] tax system, and the net revenue impact being the difference between the two. In [determining] the Mining License Tax, he relayed that an internal economic model is used which is based on projections for prices and production of metals at the major mines in Alaska, in conjunction with the review of confidential, internal information relating historical tax payments to mineral prices in the production of those mines. He explained that the reason why the note is "indeterminate" is due to the difficulty in forecasting future prices for minerals.

MR. STICKEL informed the committee that the fiscal note includes two, future pricing scenarios [page two of the fiscal note]: a high-priced scenario based on the most recent data available on the futures market on major mineral prices in Alaska and a low-price scenario which assumes that by the time the bill takes effect, that minerals prices will return to their historical, 10-year average. He provided an example of a high-price scenario for fiscal year 2012 (FY 12) of \$32.5 million generated from the existing tax compared to a low-price scenario of \$8.3 million forecasted for the same fiscal year. Both scenarios, he

noted, would include the addition of the Pogo and Kensington Mine Projects. Estimates for the production tax revenues, he explained, assume that the production at the major mines would remain constant. He highlighted that the value used in the fiscal note is the gross value - the net sales value of the minerals times production - and that no adjustments were made in the note for production and transportation expenses that would be allowable deductions under HB 418. Therefore, he remarked, the actual revenues for the production tax might be a little less and is another reason why the front of the fiscal note is indeterminate. With these factors in mind, he relayed that the net impact of changing the tax would be a "rather significant increase" in total taxes from the mining industry: approximately \$45 million under the FY 12 high-price scenario and \$39 million under the low-price scenario in the same fiscal year.

[9:13:32 AM](#)

REPRESENTATIVE WILSON, [referring to the tables on page two of the fiscal note], asked whether these revenue figures were in place of or in addition to the amounts currently received.

MR. STICKEL explained that the top line in the tables shows the revenues DOR would expect to receive under the existing Mining License Tax, the next line shows the expected revenues under the proposed tax, and the bottom line reflects the net impact of the bill.

[9:14:17 AM](#)

REPRESENTATIVE SEATON, in noting that this year's estimate of the gross value of the mining industry is \$1.6 billion, asked Mr. Stickel what gross value was used in preparing the FY 12 projections.

MR. STICKEL said that under the high-price scenario, the estimated taxable value is just over \$2.5 billion and under the low-price scenario, just under \$1.6 billion. He commented that this illustrates "the big issue when addressing minerals taxes," which is determining what the prices are going to be. He relayed that some of the experts predict it will be high and others say that "it's a bubble, ... it's going to burst, and prices are going to go back down."

REPRESENTATIVE SEATON asked whether he was correct in understanding that the current value under the 10-year-average

scenario, in spite of the two major mines coming on line, would generate the same amount of gross revenue to the state as it currently receives due to the current high price of minerals.

MR. STICKEL said that the two new mines are included in the low-price scenario.

[9:17:23 AM](#)

REPRESENTATIVE WILSON asked Mr. Stickel if he would prepare new predictions without the inclusion of the two new mines in order to compare the "real changes" [to the mining tax revenue].

MR. STICKEL indicated that both the low and high-price scenarios include the two new mines [to keep revenue comparisons constant].

REPRESENTATIVE WILSON said that she would still like to see comparisons without inclusion of the two new mines.

[9:18:19 AM](#)

REPRESENTATIVE SEATON, in explaining that certain costs, such as transportation, ball milling, and other preparations costs, are allowable deductions, asked whether DOR made any projections that reflect the percent change these costs would have on [production taxes].

MR. STICKEL said that data was not available to make this adjustment.

REPRESENTATIVE SEATON referred to a previous committee meeting where it was learned that "the mining industry would appreciate mine mouth value more than the net smelter return [(NSR)] value because it did allow the milling and the preparation of the ore before shipment" The data before the committee, he noted, does not deduct production costs for preparing the ore for shipment nor deducts the trans-shipment costs. He said that he would provide DOR with these cost estimates so a more accurate [fiscal note] could be prepared.

[9:20:03 AM](#)

CHAIR WEYHRAUCH asked whether there is any data showing at what point the tax burden would be so great that it would serve as a disincentives to mine development.

MR. STICKEL replied that this hasn't been studied explicitly, however the high- and low-price scenarios do show significantly less revenue [for the mining industry] under both types of taxes. He opined that each mine has to decide "what its cutoff price is and ... those vary significantly from mine to mine."

CHAIR WEYHRAUCH inquired as to whether there is any data showing how much is deducted before the tax is paid.

MR. STICKEL suggested that this information would be on the tax returns and he would investigate whether DOR could provide this kind of information. In response to Chair Weyhrauch, he summarized the scenarios he would prepare for the committee's review: one without inclusion of the two new mines and another showing the taxable income once the aggregate amount of deductions is taken from gross value.

REPRESENTATIVE SEATON said he provide "information on the change from the ... gross amount to percentage of net."

[9:23:55 AM](#)

JOHANNA BALES, Excise Audit Manager, Tax Division, Department of Revenue (DOR), explained the portion of the fiscal note she prepared. She clarified that there would still be significant increases to revenues in spite of deducting production costs of the mining industry. This increase, she said, would involve taking a closer look at the programs because any time a change adds more expense to businesses, then more compliance activity is required by DOR. Based on this, she relayed that one more auditor would be needed to audit and ensure compliance of that program. She explained that the fiscal note includes the added expense of this position in addition to associated costs of travel and other expenses.

REPRESENTATIVE SEATON asked Ms. Bales whether the reduction in the number of required tax returns, once the bill is in effect, was taken into consideration when preparing the fiscal note. He compared the current Mining License Tax, which requires that all those mining in Alaska file a tax form, to the tax requirement proposed in HB 418 which does not require anyone to file should they extract a value less than \$10,000.

MS. BAYLES informed the committee that there are currently 180 taxpayers filing the Mining License Tax return, the majority of which are royalty owners. With the way royalties would be paid out under the proposed Mining Production Tax, she explained,

there would still be several small tax payers filing returns that would exceed the \$10,000 threshold, especially if the tax includes "the value of the mineral versus net income."

REPRESENTATIVE SEATON relayed that with the current tax filing requirement, many people are not complying since the [amount owed] is minimal. He asked if he was correct in his understanding that this requirement is not presently enforced.

MS. BAYLES said this is accurate. Because DOR receives royalty information from the larger companies when the royalties are paid, lists can be compiled to determine whether a company has had a tax liability or not. However, she explained that the department does not spend its resources to require that someone file a return when there is no tax liability.

9:29:50 AM

KERWIN KRAUSE, Mineral Property Manager, Division of Mining, Land and Water, Department of Natural Resources (DNR), informed the committee that his position is responsible for managing the section that maintains all the mining claims and leases in addition to managing the production royalties and rentals.

CHAIR WEYHRAUCH asked how implementation of the bill would affect Mr. Krause's job.

MR. KRAUSE surmised that "going to a different royalty mechanism would make the job a little bit easier simply because [DNR] wouldn't have to conduct as many investigations and audits of the royalty returns that are filed." In response to Chair Weyhrauch's question regarding audits, he explained that current auditing examines the Mining License Tax returns because it has "all of the schedules for deductions against the gross value." He said that audits also involve review of the required affidavits of annual labor. These affidavits, he remarked, may include a variety of information on mining activity, volumes of material mined, and the amount of time spent mining. Field inspection information, he relayed, can be used to determine whether royalty returns are filed correctly or not.

CHAIR WEYHRAUCH asked whether the schedules for gross value and the information in the affidavits and from the field inspections is confidential.

MR. KRAUSE explained that the schedules for gross value "comes off the Mining License Tax return" and DOR would know of any

applicable proprietary waiting periods. However, the affidavit and field inspection information is not confidential, he said.

CHAIR WEYHRAUCH requested the committee be provided with copies of all tax-related forms the mining company is required to file. He explained that he is not requesting information from any specific company and that his interest is general.

MR. KRAUSE agreed to do so. Returning to the question of what possible impact the bill would have on his division's workload, he said this has not yet been determined.

[9:33:56 AM](#)

REPRESENTATIVE SEATON said he was given information relaying that [the royalty amounts on coal] "really haven't changed since statehood which requires a minimum of not less than five cents a ton ... with no adjustment for inflation ... and now [probably valued at] a penny a ton." He asked if the state negotiates any coal deals that are based on the minimums or does it negotiate royalties based on percent of gross similar to that proposed [in the bill].

MR. KRAUSE explained that current coal regulations have set the coal royalty at five percent of gross, and that these regulations allow the commissioner to adjust the coal royalty at a minimum of every 10 years.

REPRESENTATIVE SEATON said this explanation is "quite different" than what he's read in the statutory requirements.

MR. KRAUSE, in response to Chair Weyhrauch, relayed that the statute for coal is AS 38.05.150 and has not yet been amended since its enactment by the territorial legislature.

REPRESENTATIVE SEATON paraphrased in part subsection (d), paragraph (1) of AS 38.05.150 which read as follows:

(d) For the privilege of mining or extracting the coal in the land covered by the lease, the lessee

(1) shall pay to the state the royalties specified in the lease; the royalties shall be fixed before offering the lease, and shall be effective for a period of not more than 20 years; the royalties shall be not less than five cents a ton of 2,000 pounds; the royalty payment is subject to the exploration incentive credit authorized by AS 27.30;

REPRESENTATIVE SEATON asked Mr. Krause if this portion of the statute is no longer correct and whether the state now has another mechanism in place that deals at five percent gross royalty.

MR. KRAUSE said this is correct. In response to Chair Weyhrauch, he stated his belief that the authority for this is in AS 38.05.150, AS 38.05.020, and AS 38.05.035.

[9:37:36 AM](#)

ED FOGELS, Acting Deputy Commissioner, Department of Natural Resources (DNR), informed the committee that DNR does not have a position on HB 418 nor has "the expertise to fully evaluate the implications of changing the tax structure on the mining industry."

[9:38:56 AM](#)

DICK MYLIUS, Director, Division of Mining, Land and Water, Department of Natural Resources (DNR), relayed that Section 5, which addresses the collection of royalties, is the portion of the bill that directly affects the revenues taken in by DNR. This section, he explained, changes how the royalties are calculated from the current "net income" method to a "gross value at point of production" one. Therefore, he summarized that the impact the bill would have on DNR would only be on royalties collected for those metals mined on state land and there currently aren't a lot of large [mining] projects on state land. He said the Usibelli Coal Mine is the only major mineral development on state land which, because it only mines coal, would not be affected by [changes to royalty calculations proposed in the bill]. Fort Knox, he highlighted, is actually on Mental Health Trust land and so any revenues from that project would largely go to the Mental Health Trust, not DNR. The Pogo Mine Project, will be the first large operation to pay a significant royalty to the state. Changes to mining taxes are addressed primarily in Section 12 of the bill and would involve DOR, he continued, as well as apply to all mining development and all mineral resources, including coal and sand and gravel.

MR. MYLIUS then directed the committee's attention to the charts prepared by DNR to show the types of significant revenue generated from the five large mine projects in Alaska, only one of which is on state land. He reiterated that the Usibelli Coal Mine, on state land, would have its taxes affected by the

proposed legislation, though not its royalties. With the Red Dog Mine Project, he explained that there would be no royalties coming to the state since the operation is on land entirely owned by the NANA Regional Corporation.

CHAIR WEYHRAUCH requested further information regarding the Usibelli Coal Mine. He questioned whether totaling all the payments shown on the chart for this mine would reflect the "total government take."

MR. MYLIUS said it would and then in response to further questions by Chair Weyhrauch, he deferred to DOR for an explanation of how the income tax is calculated for the Usibelli Coal Mine operation.

[9:46:02 AM](#)

MR. STICKEL explained that any corporation doing business in Alaska is required to file a corporate income tax return with the DOR Tax Division. An S Corporation, he said, is generally exempt from filing the income tax; a C Corporation is not. The 9.4 percent listed on the chart, he continued, applies to income above \$90,000, which is the maximum tax rate of a graduated scale beginning at 1 percent on up to the 9.4 percent. He further clarified that when a company files its Alaska tax return, it's based on the company's federal taxable income and a three-piece, equally-weighted factor based on property, payroll, and sales. In response to Chair Weyhrauch, he said the return form can be simple or complex. In regard to providing the actual income taxes paid by specific corporations, he said that DOR is not allowed to release this information.

CHAIR WEYHRAUCH, referring to the charts, asked whether Usibelli Coal Mine, Red Dog Project, Greens Creek Mining Company, Fort Knox, and Pogo are all paying 9.4 percent.

MR. STICKEL said that this would be the maximum tax rate for those operations registered as a C Corporation.

CHAIR WEYHRAUCH commented that the amount of income tax to the state could "fluctuate wildly" and sought confirmation that it could only be received on an aggregate basis.

MR. STICKEL said this is correct. He relayed that he did not presently have available the statistics that would show the total tax liability for the mining industry but would provide this information to the committee.

CHAIR WEYHRAUCH asked at what point does "the tax burden become so onerous that it is a disincentive to investment and exploration."

MR. STICKEL said that this is information DOR does not currently have available but would be willing to compile for the committee.

[9:49:21 AM](#)

REPRESENTATIVE SEATON referred to page 10 of the "Legislative Research Report," Report Number 05.253, June 28, 2005, and directed the committee's attention to the section on mining in Table 3 entitled, "State Revenue Collected Through Major Taxes and Fees on the Oil and Gas, Mining, and Fishing Industries, FY 95 - FY 04." This section, he relayed, shows how "highly variable" the corporate income taxes are, ranging from \$18,000 in FY 02, \$323,000 in FY 04, \$285,000 in FY 01.

CHAIR WEYHRAUCH suggested Mr. Stickel compare this data to that available from DOR.

MR. STICKEL expressed his belief that DOR has already reviewed this, found it does match the department's internal data and, in fact, is information that was originally provided by DOR when the report was prepared.

REPRESENTATIVE SEATON returning to discussions on coal royalties as specified in the aforementioned statute, AS 38.01.150, asked for clarification on the negotiation between the state and Usibelli Coal Mine, Inc. for the 5 percent of gross royalty on coal and whether the 5 cents per ton is simply a minimum amount that could have been negotiated.

[9:52:09 AM](#)

MR. KRAUSE explained that the "five cents a ton" in the statute was the original royalty amount; however, at a later point in time regulations were implemented to make changes to the statutes. He clarified that one of the regulations dealt with royalties and one with rent. By 1982, he said, the royalty was changed from five cents a ton to "up to five percent of gross." Additionally, he highlighted that any leases in production at that time, were allowed to deduct transportation and beneficiation costs. He informed the committee that there were only three leases at that time and they all belonged to Usibelli

Coal Mine, Inc. At this same time, he said that rent was changed to \$3.00 an acre - an amount that has remained in effect and is in regulation.

REPRESENTATIVE SEATON inquired as to whether there are any similar regulations dealing with minerals.

MR. KRAUSE explained that the same kind of structure exists with the initial rental amounts in statute and updated rentals in regulations which are adjusted every 10 years according to the Consumer Price Index change (CPI). As per Representative Seaton's request, he said he would forward this information to the committee.

[9:54:33 AM](#)

CHAIR WEYHRAUCH announced that HB 418 would be held over.

[9:55:24 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:55 a.m.