

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

March 14, 2007

7:08 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Anna Fairclough, Vice Chair
Representative Bob Roses
Representative Paul Seaton
Representative Peggy Wilson
Representative Sharon Cissna
Representative Max Gruenberg

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Andrea Doll

COMMITTEE CALENDAR

HOUSE BILL NO. 61

"An Act relating to tax credits for cash contributions by taxpayers that are accepted for certain educational purposes, including vocational education programs and courses at the secondary school level; and providing for an effective date."

- MOVED CSHB 61(W&M) OUT OF COMMITTEE

OVERVIEW: MINING TAX, DEPARTMENT OF REVENUE

-HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 61

SHORT TITLE: TAX CREDIT FOR CONTRIBUTIONS TO VOC ED

SPONSOR(S): REPRESENTATIVE(S) NEUMAN

01/16/07	(H)	PREFILE RELEASED 1/5/07
01/16/07	(H)	READ THE FIRST TIME - REFERRALS
01/16/07	(H)	W&M, FIN
03/14/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

WITNESS REGISTER

REPRESENTATIVE MARK NEUMAN
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HB 61.

REX SHATTUCK, Staff
to Representative Mark Neuman
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Explained changes in the committee substitute for HB 61 on behalf of Representative Neuman, sponsor.

PAUL DICK, Chief of Operations-Juneau
Tax Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Answered questions on HB 61.

LAMONT C. ALBERTSON, Executive Director
People's Learning Center
Bethel, Alaska

POSITION STATEMENT: Testified in support of HB 61.

JOHANNA BALES, CPA, Excise Audit Manager
Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Presented an overview of Alaska's mining license tax and answered questions.

ACTION NARRATIVE

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at [7:08:13 AM](#). Present at the call to order were Representatives Hawker, Wilson, Fairclough, Roses, and Seaton. Representatives Gruenberg and Cissna arrived as the meeting was in progress. Representative Doll was also in attendance.

HB 61-TAX CREDIT FOR CONTRIBUTIONS TO VOC ED

[7:09:16 AM](#)

CHAIR HAWKER announced that the first order of business would be HOUSE BILL NO. 61, "An Act relating to tax credits for cash contributions by taxpayers that are accepted for certain educational purposes, including vocational education programs and courses at the secondary school level; and providing for an effective date."

REPRESENTATIVE MARK NEUMAN, Alaska State Legislature, speaking as the prime sponsor of HB 61, explained that much of the bill currently exists in statute because current law allows tax credits for donations to post-secondary schools. The bill's provisions would also allow taxpayers to take a tax credit for their donations to secondary schools. He explained that the credit allowed is the lesser of: an amount equal to 50 percent of contributions of not more than \$100,000 and 100 percent of the next \$100,000; or 50 percent of the taxpayer's net liability under Title 43. He explained that a taxpayer who contributes \$200,000 to vocational education could take a tax credit of \$150,000. He noted that major corporations can pay upwards of \$2 million in taxes annually. He went on to say that a credit of \$150,000 is not a huge reduction in the amount of taxes the state receives, but that a donation of \$200,000 would be a tremendous benefit to a vocational education program. He said that he believes vocational education programs are an important component of education, particularly in rural Alaska.

[7:12:58 AM](#)

CHAIR HAWKER clarified that existing statutes allow for certain tax credits, and that this bill allows for taxpayers to avail themselves of an additional tax credit for donations to high schools, secondary schools, and vocational education programs.

REPRESENTATIVE NEUMAN agreed that most of the provisions in the bill are already in statute, but this bill expands the ability of taxpayers to receive a tax credit for donations at the secondary level, which he opined could have a positive effect on graduation rates at the high school level. He assured the committee that the amounts of credits currently authorized by statute have not been changed.

REPRESENTATIVE SEATON, in response to a question about the bill's effective date, reminded the committee that an effective date other than 90 days after a bill has passed requires a two-thirds vote of each house.

[7:15:44 AM](#)

REPRESENTATIVE FAIRCLOUGH moved to adopt the proposed committee substitute (CS) for HB 61, Version 25-LS0302\C, Bullock, 3/12/07. There being no objection, Version C was before the committee.

[7:16:30 AM](#)

REX SHATTUCK, Staff to Representative Mark Neuman, Alaska State Legislature, explained that Version C is intended to clear up some areas by standardizing language throughout the sections and clarifying the descriptions contained in the first section.

CHAIR HAWKER clarified that the bill contains tax credits that already exist which various taxpayer can apply to their state tax liabilities.

[7:17:45 AM](#)

REPRESENTATIVE WILSON expressed her support of vocational education programs.

[7:18:27 AM](#)

REPRESENTATIVE NEUMAN said that industry has stated it would like to support vocational education efforts.

[7:19:15 AM](#)

REPRESENTATIVE SEATON noted that the tax credit applies to the state's corporate income tax and asked whether it would also apply if the state enacted a personal income tax.

PAUL DICK, Chief of Operations-Juneau, Tax Division, Department of Revenue (DOR), agreed that the bill's credit provisions apply to corporate income taxes. He went on to say that application to a personal income tax would have to be determined after any change to the tax laws. In response to a question, he explained that the property tax education credit in Section 4 applies only to oil and gas property taxes paid to the state, not to municipal property taxes.

[7:22:20 AM](#)

CHAIR HAWKER noted that the bill allows a taxpayer to take a credit against certain taxes should the taxpayer decide to make a contribution to vocational education.

[7:22:30 AM](#)

MR. DICK said that in fiscal year (FY) 2005, there were \$5 million in contributions made to educational institutions, which resulted in tax credits of \$2.5 million claimed against the various tax types, such as corporate, mining and fisheries business taxes.

[7:23:50 AM](#)

LAMONT C. ALBERTSON, Executive Director, People's Learning Center, explained that the People's Learning Center ("center") combines post-high school secondary vocational education and is heavily involved in work force development. He said that the bill would allow his center to accept corporate contributions. He emphasized that rural Alaska needs work force development and training to help sustain communities, families, and the region. He said that any steps that would encourage corporate involvement would be positive.

[7:25:43 AM](#)

REPRESENTATIVE SEATON asked whether any funds received will qualify the center for matching grant funds.

MR. ALBERTSON replied that there could be matching funds and he would certainly pursue any opportunity to obtain them.

[7:26:21 AM](#)

REPRESENTATIVE CISSNA asked how much was currently invested in the center.

MR. ALBERTSON replied that he anticipates the project will cost about \$25 million, including in-kind contributions. Thus far, about \$18 million has been raised. He explained that the center provides a broad range of vocational training opportunities.

[7:28:00 AM](#)

CHAIR HAWKER asked about the possible tax effects of this bill on the state treasury.

MR. DICK replied that it is hard to predict how many taxpayers will use this tax credit. He said that over the last few years, the credit program has remained fairly static with about \$5

million in contributions that resulted in \$2.5 million in credits. He responded to a question by noting that the bill does not cover the particulars of whether a donor can dictate how their donated funds are spent.

[7:31:11 AM](#)

REPRESENTATIVE SEATON asked if a single contributor can donate \$1.5 million to the allowable entities.

MR. DICK replied that a donor can contribute \$1.5 million, but the tax credit would be \$150,000. He said that currently some corporate contributors make large contributions, but only claim \$150,000 in tax credits.

[7:31:46 AM](#)

REPRESENTATIVE WILSON moved to report CSHB 61, Version 25-LSO0302\C, Bullock, 3/12/07 out of committee with individual recommendations and the accompanying indeterminate fiscal note. There being no objection, CSHB 61(W&M) was reported from the House Special Committee on Ways and Means.

[7:32:07 AM](#)

Overview: Mining Tax, Department of Revenue

CHAIR HAWKER announced that the next order of business would be an overview of the state's mining tax laws by the DOR.

JOHANNA BALES, CPA, Excise Audit Manager, Tax Division, Department of Revenue (DOR), explained that mining taxes were imposed beginning around 1913. Over the years, the tax rates have fluctuated somewhat. The last major change to the mining license tax was in 1955. Since that time, there has been a series of tax credits applied to the mining tax structure.

[7:36:55 AM](#)

REPRESENTATIVE WILSON asked why tax credits were enacted between 1987 and 2002.

MS. BALES replied that during times of low mineral prices, tax credits were used to encourage exploration and development of the state's mineral resources. She went on to explain that tax credits offset tax liability. During times of low prices there

is often no income, and thus no tax liability against which to apply a credit. Therefore, the credits were not used often, she said. She explained that the current tax rate structure applies a base tax amount which varies depending on net income. In addition to the base amount, the taxpayer pays a percentage based on its entire net income, which varies depending on the amount of net income.

[7:39:11 AM](#)

REPRESENTATIVE GRUENBERG asked whether there has been consideration of taxing gross mining income.

MS. BALES replied that she was aware of a bill last year to levy mining taxes on gross income rather than net. She noted that changes in tax structures can be difficult and confusing for the taxpayer. In response to further inquiry, she stated she is not aware of whether other states review tax credits as circumstances, such as mineral prices, change. She said she is willing to research this issue and the issue of taxation based on gross income for members of the committee.

[7:41:36 AM](#)

MS. BALES referred to a chart title "Tax Collections" which was provided to the committee and noted that mining license tax revenues had been fairly flat from FY 97 through FY 04. However, the tax revenue has been increasing since FY 05 and is expected to continue to increase in FY 07 and FY 08. This is due to higher mineral prices as the number of taxpayers has remained fairly static, she said.

MS. BALES explained that persons are required to have a mining license for property in the development or producing stage regardless of whether land is owned by the state or federal government, or by a private party. A person is required to hold a mining license when that person either: owns and operates mining property; owns and receives lease or royalty payments based on production; leases and operates a mining property; or possesses a mineral interest in a producing property.

[7:44:26 AM](#)

REPRESENTATIVE SEATON asked whether an entity such as the Alaska Mental Health Trust Authority (AMHTA) must have a license if its land is being explored for mineral production.

MS. BALES replied that the AMHTA would not need a mining license because it is an arm of the state. However, a private landowner, such as a Native corporation, must have a license and report royalties for any mining income from its property.

[7:45:38 AM](#)

MS. BALES responded to a question by explaining that a license from DOR is not required during the exploration phase of mining development. The Department of Natural Resources (DNR) issues permits for exploration activities on state land, she said.

[7:46:01 AM](#)

REPRESENTATIVE WILSON expressed interest in whether mining exploration activities in the state have increased.

[7:46:16 AM](#)

CHAIR HAWKER asked whether the mining license tax is required of the property owner only, or whether it is also required of a lessee or operator of a mining property.

MS. BALES said that it would be required in both instances. Anyone who owns and operates, or leases and operates mining property must have a license. She explained that a license is not needed if mining activities are restricted to holding of property for exploration, or if a person simply holds a mineral interest in undeveloped and non-producing properties. Last, no license is required if the mining activity consists of extracting sand, gravel, and rock for public or private construction.

[7:48:17 AM](#)

REPRESENTATIVE GRUENBERG asked whether other jurisdictions levy taxes on non-producing property, noting that sometimes valuable mineral assets are not produced due to low prices or other reasons.

MS. BALES was not aware of whether research had been done on the aforementioned issue. She pointed out that taxes could only be applied to mineral interests on state lands, but not on private or federal lands due to the lack of state jurisdiction on those properties. She said she is not aware of how the federal government treats held, but non-producing, mineral interests.

7:49:57 AM

REPRESENTATIVE ROSES asked whether both a landowner and a lessee that operates mining activities on the land would have to pay taxes on mining income and whether they both pay at the same rate.

MS. BALES replied that both the owner and the lessee would be liable to pay the mining tax, but she noted that the lessee could deduct its royalty costs from its net income. She also said that the same percentage of tax liability applies to both the owner and the lessee.

7:51:01 AM

MS. BALES related that a holder of a mining license must file a mining license tax return. A person receiving gross income from more than one licensed mining property must aggregate and report that income on a single return. Furthermore, there is an exemption from the mining license tax during the first three and one-half years of production. She indicated that many mining companies operate at a loss during the first three and one-half years of production.

MS. BALES emphasized that the mining license tax is an income tax which is calculated on net income from the mining property. The taxable net income is the gross income, less royalties paid and mining expenses. Gross income includes the sales price or value received for mined minerals, any royalties received from mining property, and production payments received from a lease. Once gross income is determined, the taxpayer can deduct direct and indirect mining expenses to determine net income. Direct expenses are incident and necessary costs for the extraction of mined minerals and include labor, maintenance, repair costs, supplies, depreciation, transportation, and depletion.

7:55:21 AM

REPRESENTATIVE SEATON asked whether there is scheduled depreciation, or whether a capital investment is deducted in a single year.

MS. BALES replied that the mining depreciation schedule is based on federal law and allows the deduction of an asset's cost, within certain limits, in a single year. The federal depreciation schedule allows use of accelerated rates, she said.

Ms. Bales went on to say that indirect costs are those supporting costs that are not directly related to mining, such as advertising, employee benefits, administrative expenses, and other taxes.

[7:57:06 AM](#)

MS. BALES responded to a question by explaining that the method of worldwide apportionment for tax calculation applies to the corporate income tax. She said that corporations that pay mining license taxes are also required to pay corporate income tax. Mining entities and other non-oil and gas businesses are required to calculate their corporate tax using a "water's edge" method. This method considers only income earned within the "water's edge" of the United States. For the mining license tax, the DOR considers only the mining activities in the state and the income and deductions that apply to the mining activity. She reminded the committee that an owner of multiple mines must aggregate income from all mines in the state for purposes of the mining license tax. She explained that the worldwide apportionment tax concept applies only to corporate income tax calculations for oil and gas companies.

[7:59:36 AM](#)

REPRESENTATIVE GRUENBERG asked whether it would affect the state's revenue if a worldwide apportionment concept was adopted for the mining industry.

MS. BALES responded that she was not aware of the effect of such a decision without having further knowledge of a company's worldwide business activities.

[8:00:15 AM](#)

MS. BALES informed the committee that deductions not allowed to determine net income include exploration costs, federal income taxes, the mining license tax, loss on the sale of mining equipment or property, net operating losses, and other capital losses. She emphasized that the mining license tax focuses on what happens in one calendar year. Taxpayers are not allowed to carry over their losses from past years as a credit against future gains, she said. She summarized that the state shares in the income earned, but not in the losses. In contrast, other corporate taxpayers can apply losses from previous years to offset current income, she explained. She reminded the

committee that the mining license tax is in addition to the corporate income tax.

[8:05:05 AM](#)

MS. BALES described depletion as the term used for depreciation of mineral property used to extract natural resources. This means that capitalized costs incurred during the development stage can be depleted or depreciated once the mine begins production. The taxpayer may deduct whichever method of depletion, cost or percentage, results in the greater deduction. Cost depletion allows an owner to deduct its total development costs over the estimated life of the mine. Once these costs are deducted there is no more cost depletion. The other method, percentage depletion, is based on a percentage of gross income less royalties paid. It is limited to no more than 50 percent of net income, she explained.

[8:09:26 AM](#)

REPRESENTATIVE WILSON asked about the situation in which further mineral deposits are discovered after all costs are depleted.

MS. BALES replied that it may depend on whether the additional discoveries count as a new property. She said that additional development costs after initial production are immediately deductible, and the taxpayer is still allowed to take percentage depletion after it has depleted all its cost depletion.

[8:10:26 AM](#)

REPRESENTATIVE GRUENBERG asked whether the taxpayer must elect between cost and percentage depletion.

MS. BALES explained that each year a taxpayer may calculate its tax liability under each method and choose the method most favorable to it.

[8:10:59 AM](#)

REPRESENTATIVE SEATON asked about the effect of increasing mineral prices on percentage depletion, and whether the application of percentage depletion is allowed after the taxpayer has deducted all of its development costs.

MS. BALES agreed that in the aforementioned situation, the taxpayer could use percentage depletion. She noted percentage

depletion was developed decades ago by the federal government and has been used for years. She said that it allows a deduction that cannot be taken through net operating losses or exploration costs.

[8:12:59 AM](#)

MS. BALES responded to a question by explaining that most states and the federal government allow taxpayers to annually choose between cost and percentage depletion. She explained that the calculations for each method are different. For example, a mine that operated with positive income for a 10-year period could have a depreciation deduction that significantly exceeds the development costs. As a mine earns more income, percentage depletion may result in a more favorable tax deduction, she explained. In the situation where a mine has net operating losses, it is required to calculate cost depletion and deplete its development costs even though it does not yet have any net income. She explained that percentage depletion can result in an overall deduction in the life of the mine that may be greater than total development costs, but overall the mine may have lost money.

[8:18:23 AM](#)

REPRESENTATIVE WILSON asked whether it is typical for mines to continue to operate despite losses.

MS. BALES replied that mines can incur losses or temporary closures over the years, especially since mineral prices fluctuate. She reiterated that it is typical to have losses in the first years of production.

[8:19:48 AM](#)

MS. BALES explained that the statutory depletion rates vary with the mineral. The depletion rate for coal is 10 percent, for metal mines - gold, silver, copper, lead, and zinc - it is 15 percent. Percentage depletion is not allowed for sand and gravel operations, only cost depletion, she said.

[8:20:32 AM](#)

MS. BALES said that once gross income is calculated, the taxpayer can then deduct its expenses - direct and indirect costs, royalties paid, depletion - for the current year to arrive at its net income. The taxpayer then applies the

statutory tax rates to its net income to determine its tax liability. Once tax liability is determined, the taxpayer may apply for a tax credit. Tax credits are applied dollar for dollar against the tax liability. The most significant tax credit allowed is for exploration costs incurred up to \$20,000,000. Exploration costs include surveying, drilling exploration holes, underground exploration, sampling, and metallurgical testing. The exploration costs tax credit must be applied with 15 tax years of credit approval by the DNR and may only be used to offset 50 percent of tax liability. She noted that this credit has not been used very often because it must be used within 15 years, and mines often have operating losses in the first 5 to 7 years of operation.

[8:23:01 AM](#)

REPRESENTATIVE FAIRCLOUGH inquired as to whether a mining producer can apply for an exploration cost credit 15 years into a 50 year mining project.

MS. BALES replied that she believes there is a time limit within which a mine must apply to DNR for an exploration costs credit and that the taxpayer can only apply for this credit after the development stage, but prior to the production stage.

[8:24:09 AM](#)

MS. BALES went on to say that allowable tax credits also include education credits of up to \$150,000 for contributions made to public or private nonprofit two or four-year colleges or universities in Alaska. The taxpayer can take a credit for 50 percent of the first \$100,000 of its contributions and 100 percent of the second \$100,000 in contributions. This credit can be taken against 100 percent of tax liability. Mining operations that also pay corporate income tax can apply the exploration costs tax credit or the education credit against their mining tax or against their corporate income tax, but not against both.

REPRESENTATIVE SEATON asked whether a corporation can apply the exploration tax credit to reduce its corporate income tax liability even if the mining business that generated the exploration costs is not in production.

MS. BALES replied that she was not sure, but opined that the taxpayer is required to be engaged in mining activity to take the exploration costs credit.

[8:27:00 AM](#)

MS. BALES responded to Representative Gruenberg's inquiry by explaining that a taxpayer can choose annually whether to take a credit against either its mining tax or its corporate income tax liability. She stated that the mining tax has been a net income tax since 1913, and that increases in revenue have been due to increases in the value of mined minerals. She reminded the members that the state shares in the income of a mining property, but not in the losses and that most companies have losses during the first three and one-half years of production. The exploration costs credit has been in existence since 1995 to provide an additional incentive to develop the state's minerals, but has not been taken very often.

[8:28:40 AM](#)

CHAIR HAWKER clarified that two agencies are heavily involved in mining issues: DOR and DNR. The DOR administers the tax laws, while the DNR administers royalty issues.

MS. BALES agreed with the above characterization, and explained that the owner of the property owns the right to royalties. If the state is the property owner, it is the royalty holder. The state collects about \$1.5 million in mining royalties because much of the larger mining operations in the state take place on federal, native corporation, or AMHTA lands.

REPRESENTATIVE SEATON clarified that the royalty structure is basically 3 percent of mining license net income.

[8:31:17 AM](#)

REPRESENTATIVE CISSNA noted that mineral prices fluctuate greatly and asked about the dynamics that affect the prices.

MS. BALES stated that the economies of mining exploration are driven by the forces of supply and demand for various minerals and that the DOR economists do look at trends in the mining industry.

[8:33:36 AM](#)

REPRESENTATIVE CISSNA asked about the history of mining revenue and when the state last received the amount it is currently receiving.

MS. BALES said that she researched past mining revenue records and did not find a time when mining revenues were higher than the state is currently receiving. To further research this, she would have to determine whether there are records of mining revenue before the 1950s. She explained that mining development requires consideration of many factors, such as mineral costs, exploration, and reclamation costs. Her past research indicates that mining in Alaska is very expensive, even in areas that are somewhat accessible.

[8:36:28 AM](#)

REPRESENTATIVE SEATON asked whether other state royalties are based on net income, noting that in other areas the state receives royalties based on considerations such as value at point of production. He also asked how the AMHTA royalty structure works.

MS. BALES said she is not aware of other royalties that are based on net income, nor is she aware of how the AMHTA royalty structure works.

[8:37:40 AM](#)

REPRESENTATIVE WILSON asked about general revenue increases for mineral extraction as mineral prices go up, noting that it appears that mining revenues have risen with the price of minerals while perhaps taxes received from oil production did not.

MS. BALES related her understanding that the state did receive higher production tax receipts as oil prices rose, just as mining tax revenues have gone up as mineral prices increase.

CHAIR HAWKER clarified that oil and gas production taxes have increased as wellhead values for oil and gas rose, noting that in 1999 the state received \$358 million in unrestricted oil and gas revenue, and recently that figure has risen to \$1.2 billion. He noted that the mining license tax is very much a production based tax.

[8:39:34 AM](#)

MS. BALES responded to a question by noting there is nothing in the mining license tax comparable to the economic limit factor (ELF) that applies to some oil and gas production.

CHAIR HAWKER reminded the members that the ELF is a mechanism unique in the state to make accommodations for various costs from oil and gas fields with different production levels. In comparison, the mining license tax demands specific identification and accounting for costs by the operators, whereas ELF allows estimates in making the determination of applicability.

[8:41:53 AM](#)

MS. BALES offered to research Representative Gruenberg's inquiry of whether other jurisdictions have changed their tax rate structure over the last 50 years.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at [8:43:50 AM](#).