

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

March 16, 2007

8:35 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Anna Fairclough, Vice Chair

OTHER LEGISLATORS PRESENT

Representative Andrea Doll
Representative Mike Kelly

COMMITTEE CALENDAR

HOUSE BILL NO. 156

"An Act relating to mining licenses, to the mining license tax, and to production royalties on minerals and rents for property involved in mining; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 156

SHORT TITLE: MINING PROD. & LICENSE TAXES/ROYALTIES

SPONSOR(S): REPRESENTATIVE(S) SEATON

02/26/07	(H)	READ THE FIRST TIME - REFERRALS
02/26/07	(H)	W&M, RES, FIN
03/16/07	(H)	W&M AT 8:30 AM HOUSE FINANCE 519

WITNESS REGISTER

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HB 156.

NEIL MACKINNON, Owner
Hyak Mining Company
Juneau, Alaska

POSITION STATEMENT: Expressed concerns with HB 156 and answered questions

CHARLIE BODDY, Vice President
Governmental Relations
Usibelli Coal Mine, Inc.
Fairbanks, Alaska

POSITION STATEMENT: Expressed concerns with HB 156 and answered questions.

ACTION NARRATIVE

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at [8:35:37 AM](#). Present at the call to order were Representatives Hawker, Wilson, Gruenberg, and Roses. Representative Fairclough was excused. Also present were Representatives Doll and Kelly.

HB 156-MINING PROD. & LICENSE TAXES/ROYALTIES

[8:36:59 AM](#)

CHAIR HAWKER announced that the only order of business would be HOUSE BILL NO. 156, "An Act relating to mining licenses, to the mining license tax, and to production royalties on minerals and rents for property involved in mining; and providing for an effective date."

REPRESENTATIVE SEATON, sponsor of HB 156, said that now was an opportune time to consider changes to the state's mining tax regime. He referenced a poll by Hellenthal and Associates, dated February 12th to 20th, 2007, ("Hellenthal poll"), a copy of which was provided to the committee which indicated the public does not consider the current mining tax regime to be too high. Furthermore, he noted that legislative action is an appropriate way to approach taxes. He reminded the committee that recently proposed legislation to impose a head tax on the cruise industry stalled in the legislature, but was then part of a successful initiative that included a head tax, an ocean ranger program, a corporate tax, a tax on gambling, and imposed additional permitting requirements on the cruise industry. In comparison, HB 156 is very precise and proposes reasonable

adjustments to the industry tax structure without undue harm to the mining industry. He said that the mining tax has not been significantly amended in over 50 years. In 1989, in response to a United States Supreme Court decision, the legislature made changes to the mining tax regime and imposed both rents and royalties on the state's mining industry. He explained that, under current law, when 20-year mining leases between the state and mining operators are renewed, the rental fees charged are adjusted by the Consumer Price Index (CPI) in Anchorage.

[8:43:54 AM](#)

REPRESENTATIVE SEATON referenced the Annual Survey of Mining Companies 2005/2006, published by The Fraser Institute ("Fraser report"), and explained that it is an annual survey of metal mining and exploration companies worldwide. The survey sets forth its results in an index which assesses how an area's mineral potential and taxation regime affect that region's attractiveness for mine development. The March 2006 Fraser report ranks Alaska as 7th out of 64 regions worldwide in the factors of attractive mining policy and mineral potential. Alaska ranks as the 2nd most favorable for its mining taxation regime out of the same 64 regions. He opined that Alaska's tax regime may be favorable to the mining companies, but perhaps not so favorable to policy makers charged with obtaining a reasonable revenue return for the state's resources.

[8:46:31 AM](#)

REPRESENTATIVE ROSES asked how much mining activity occurred in Alaska compared to some other areas studied by the Fraser Institute.

REPRESENTATIVE SEATON indicated he can supply a report that covers the aforementioned area and noted that the Fraser report is very detailed.

REPRESENTATIVE ROSES noted that under the Hellenthal poll approximately 28 percent of persons polled consider mining activities anywhere from unimportant to very unimportant to the state. He wondered how many of those who indicated a lack of interest in mining also indicated a desire to increase mining taxes. He opined that a person who does not care about an industry's existence would not be concerned with taxing that industry out of existence.

[8:48:49 AM](#)

REPRESENTATIVE SEATON predicted that if a vote on this issue was presented by initiative, people may vote in favor of increased taxation for various reasons.

REPRESENTATIVE ROSES noted that sometimes public opinion changes during an initiative campaign and asked whether there was additional information about the Hellenthal poll.

REPRESENTATIVE SEATON explained that he became aware of the Hellenthal poll in a different committee, and that there may be some additional information not yet made public.

[8:50:11 AM](#)

REPRESENTATIVE SEATON referred to a committee hand out titled "Non-renewable Resource Tax Comparison Chart," ("comparison chart") that compares the current mining tax structure with the proposed mining tax changes in HB 156 and with the 2006 changes to the state's oil production profits tax (PPT). He noted that non-renewable resources are taxed somewhat differently than renewable resources.

[8:51:45 AM](#)

REPRESENTATIVE WILSON asked how the changes proposed in the bill would affect Alaska's ranking on the Fraser report.

REPRESENTATIVE SEATON replied that in last year's discussion of the PPT, he recalled testimony from oil companies that they wanted a tax restructuring for their industry because the tax had not been changed for quite some time. The industry favored changes that they felt would remain for quite some time so as to add stability to the taxing regime, he opined. He reminded the committee that the mining license tax had not been changed for 55 years, and that investors may feel uneasy if they believe a taxing regime is going to change. He said that he thinks that a reasonable change to the mining tax structure may be looked at favorably by the mining industry as it could provide stability in the area of taxation. He responded to a question by stating that research sources which compare various tax regimes include known factors, including the variety and rates of taxes, within a jurisdiction.

[8:53:37 AM](#)

REPRESENTATIVE SEATON referred to the comparison chart and explained that current mining tax rates are based on four levels of mining net income, with taxation rates that vary from 0 to 7 percent. Under current law, there is no tax for mines with a net income of less than \$40,000, although the taxpayer must file a return. The proposed changes would not eliminate the exemption from taxation for mines with less than \$40,000 in income, but would eliminate the requirement that these mines file a return. He explained that the state has many small, recreational mines that do not earn more than \$40,000 in income and that filing a tax return engenders a lot of paperwork when no tax liability is due. He went on to say that the bill proposes to increase tax rates for income categories more than \$40,000 by 2 percent and it adds a category for mines with income of more than \$500,000. These mines would be taxed at 11 percent of net income. He explained that the bill does not propose an escalator factor, unlike the PPT where the tax rates increase as the price of oil increases. He noted that in PPT there is a 4 percent minimum tax percentage based on the gross value of production if oil is less than \$25 a barrel. He pointed out that in PPT, there are 18 different categories of expenses that the producers are disallowed from deducting from gross income to arrive at net income. He said that net income for purposes of the mining license tax is much different than net income under PPT.

[8:58:40 AM](#)

REPRESENTATIVE SEATON explained that current mining tax law exempts a mine from taxation for its first three and one-half years of operation. The proposed changes would grant a three and one-half year tax deferral for new mines, which would be payable over a period of 10 years. He said this change would likely not have any adverse affect on revenues because mines do not usually make any money in their first years of operation; therefore, there is no tax to defer because there is no net income to tax. The decision to allow new mines to defer, but not forgive, taxes for the first three years and one-half years is a policy call that recognizes some mining operations have the potential for revenue even in the early years of operation.

[9:01:01 AM](#)

REPRESENTATIVE ROSES asked about the effect of the bill on current operators who have the benefit of the three and one-half year tax exemption.

REPRESENTATIVE SEATON replied that current operators would be covered by current law, and reminded the committee that the Department of Revenue (DOR) does not recall any mining operation actually invoking the tax exemption for the first three and one-half years of mining operations.

[9:01:48 AM](#)

REPRESENTATIVE SEATON went on to say that the bill's provisions allow a deduction for cost depletion only. Current law allows a taxpayer to choose between cost depletion and percentage depletion. He noted that percentage depletion can allow the taxpayer to use percentage depletion once all cost depletion is exhausted, which can result in a tax deduction of three to four times the actual capital costs.

[9:02:51 AM](#)

REPRESENTATIVE GRUENBERG asked whether there has been research as to whether Alaska's current mining tax regime encourages, discourages, or has no effect on development of the state's mineral resources.

REPRESENTATIVE SEATON indicated that there is a fair amount of exploration for potential new mines in the state. He said that the Fraser Institute surveys mining executives worldwide and rates jurisdictions on various aspects, such as governmental policies, taxation regimes, and resource potential. He opined that it is a policy choice of the state to determine how it wants to structure its taxes, and that the state could decide to have a very favorable mining tax regime in an effort to attract mining jobs. He went on to say another aspect to consider in setting tax policy could be consideration of state revenues and constitutional obligations.

[9:05:44 AM](#)

REPRESENTATIVE GRUENBERG said he believes it is difficult to compare Alaska with other regimes because there are significant political and geographical differences. He went on to say his concern is perhaps within the purview of DOR and it is how the state is doing with regard to mining activities compared to where it ought to be in the ideal world.

[9:07:32 AM](#)

REPRESENTATIVE SEATON opined that Canada may be a good comparison to Alaska, and noted that British Columbia's policy and mineral potential is ranked 11th most favorable, while Alaska is ranked 6th in this same category. He opined that the Fraser index tries to summarize where mining companies are most likely to invest. He said that it is difficult to structure taxes for industries based on non-renewable resources.

[9:10:28 AM](#)

REPRESENTATIVE CISSNA asked whether there is information on the relative costs of mining in other jurisdictions.

REPRESENTATIVE SEATON stated that the rating system relies on knowledgeable mining executives who are familiar with the factors of resource potential, costs, and taxation. The Fraser Institute reports how mining executives view various jurisdictions in various categories, and opined that this is a difficult policy decision for the state to decide how to structure its mining taxation system. He said he researched and considered the issue of mining taxes for three years. During that time he considered taxes based on gross income, point of production, or mine-mouth value, to determine ways to increase revenues received from mining operations. His research included much discussion with the mining industry. He noted that in the past 10 years, Alaska has not received much revenue from mining taxes. He went on to opine that the bill is the best compromise to assure a reasonable return, yet impose a taxing regime that will not damage Alaska's attractiveness to industry investment. He also noted that Alaska's mining tax scheme is over 50 years old, and a change would provide some comfort to mining executives that the taxes would not change again soon.

[9:15:16 AM](#)

REPRESENTATIVE SEATON explained that the under prior law, the state corporate income net tax was being deducted from the mining license net tax. He said he will offer an amendment to the bill to propose that federal and state income taxes are not deductible from the mining license net income tax. He reminded the committee that changes to PPT disallowed deductions of one net tax from another net tax.

[9:16:40 AM](#)

REPRESENTATIVE SEATON said that the royalty provisions of the bill remain the same for coal mining - 5 percent of adjusted

gross income. For metal mines, the bill proposes a change from 3 percent of net income to 3 percent of net smelter return. He explained royalty payments are to compensate the state for the use of its resources, and under the prior system, the state's royalty amount was based on the mine's income. Therefore, the state's royalty share was reduced if the company was not operating efficiently. He noted that most mines in Alaska are not on state land, but are on Alaska Mental Health Trust Authority (AMHTA) or native-owned land. On those lands, the mining industry may pay royalties of up to 5 percent. Some royalty provisions on private land are based on a sliding scale which adjusts depending on the price of minerals. He opined that since the mining industry will pay 5 percent of net smelter return on private property, it could also pay a similar amount to the state.

[9:19:29 AM](#)

CHAIR HAWKER asked whether net smelter return calculations appear elsewhere in state law and whether it is a known concept within the mining industry.

REPRESENTATIVE SEATON replied that he believes the concept is used in contracts in the state, such as mining contracts on AMHTA lands. He noted it is also used in other jurisdictions, such as Canada and other countries. He went on to say if it was not defined in the bill, he would make sure a definition appears.

[9:21:11 AM](#)

REPRESENTATIVE GRUENBERG asked whether there is research as to whether mining companies were asked whether they viewed investment on state or private lands differently due to the different tax regimes that apply.

REPRESENTATIVE SEATON responded that the mining officials interviewed are familiar with Alaska industry and know that most mines are not on state lands. He opined that their estimations are based on their extensive knowledge. He noted that the bigger mines, such as the Red Dog Mine, are not on state land, and thus pay a net smelter return royalty.

[9:22:57 AM](#)

REPRESENTATIVE GRUENBERG observed that Alaska is currently ranked as the 6th most favorable mining jurisdiction, even

though most mining operations are operating on private land, and are paying more royalties than those companies would pay to the state. He went on to opine that this situation may support the conclusion that Alaska would still be viewed favorably for mining even if it increased the percentage of royalty payments required for mining operations on state land.

REPRESENTATIVE SEATON indicated agreement with the aforementioned observation.

9:24:00 AM

REPRESENTATIVE ROSES asked whether the mining operations on, for example, AMHTA lands, are subject to other state taxes, such as the mining license tax, that would apply to mining operations on state land.

REPRESENTATIVE SEATON replied that mining operations are subject to all state taxes regardless of where the mining operations take place.

9:24:39 AM

REPRESENTATIVE SEATON explained that the state charges rent of \$3 an acre for coal under the current law and under HB 156. The bill proposes to include rental rates in statute instead of by regulation, as is the current practice. Mineral rents are currently charged based on a sliding scale that ranges from \$.50 to \$2.50 an acre. Every 20 years, the rents are evaluated and readjusted based on the CPI for Anchorage. He explained that this protects the mines as they know the rental structure and are able to calculate any rent increase. Under the bill, the structure would stay similar. The mineral rents would rise to \$3.30 per acre, which is what the price would be if any of the current 20-year leases were re-negotiated based on the CPI for Anchorage. The bill uses 2005 as the base year from which to calculate the adjustments based on the CPI. Furthermore, mining leases with the state under current law are for 20 years. The bill proposes to change state leases to a 10-year period. The reason for that change, he explained, is based on some discussion and advice from the Department of Law (DOL) in other areas regarding the ability of the state's ability to limit or fix factors such as rents and taxes.

REPRESENTATIVE SEATON addressed the difference between taking royalty-in-kind and royalty-in-value. He said that the Department of Natural Resources (DNR) had estimated that it

could save the state about two and one-half million dollars a year if the University of Alaska power plant in Fairbanks could use royalty coal to power its plant. He said that the royalty-in-kind provisions would likely not apply to existing leases, but could be considered in the negotiation of new leases.

[9:32:17 AM](#)

NEIL MACKINNON, Owner, Hyak Mining Company testified that past imposition of a 5 percent net smelter tax in 1948 resulted in the closure of a Fairbanks mine which did not re-open until 1972. He said that the current mining tax regime has been in existence since 1955, with some modifications made in the late 1980s when a court decision held the state must either collect rents or royalties from mining operations on state land. He said that the state imposed both rents and royalties. He opined that charging royalties based on net smelter return instead of net profits is a major change. He said that as a prospector, he makes his living by exploring for minerals and can offer prospects for companies to pursue for development. He indicated that if changes were made to the mining tax structure, he would not be able to continue to explore in the state. He went to say that the survey by the Fraser Institute is not current, and reviews years of economic challenge for the mining history. He said that the current climate for mining, and thus for positive mining revenues, has improved and the state may be receive more favorable revenue returns from mining in the future.

[9:36:51 AM](#)

MR. MACKINNON opined that Alaska is not quite as attractive a place for mining activity as last year's Fraser report would indicate. He said it was his understanding that under current Alaska mining law a taxpayer has to chose between cost depletion and percentage depletion at time of development and that the taxpayer can not make an election between cost and percentage depletion each year. He went on to say that oil and gas is a different industry from mining, and that, within mining, each mineral is different. Within minerals, there are a variety of quality issues which affect profitability. He said that raising the royalty requirement by 3 percent will cut income by 3 percent, and may require the mining operator to have to mine higher quality rock. He said that years ago he compared mining operations in Alaska with mining operations in other states. He said his conclusion was that in Alaska one-third of each dollar made through mining went to the mining company, another third to labor and the remaining third went to government. He said that

that under his model, he got the same result if he considered moving the mining operation to Nevada or Idaho. The one factor that can be adjusted is how much money the state receives, as one could not reduce the amount that goes to mining capital or labor, he opined. He said that his small company could not afford much risk, and that it puts approximately 10 to 15 percent of its income into exploration. This year he said that his company is not exploring in Alaska, but instead is exploring in Nevada because it cannot afford political risks. He indicated that other mines in Alaska may be affected. He said that wealth in the ground is of no value until it is produced.

[9:42:09 AM](#)

CHAIR HAWKER asked the witness' opinion on the affect the bill could have on Couer Alaska's Kensington Gold Mine ("Kensington").

MR. MACKINNON opined that since the Kensington was currently in the process of building mining structures, it would likely "have to live" with any changes to the tax structure. He said it could be mothballed. He explained that for years many large mines will operate and provide jobs at a low return of 3 percent annually in the hope of receiving a much higher return for one year. He opined that it is of value to have a mine operate at a low return rate so as to provide jobs and infrastructure, particularly in rural areas.

[9:43:47 AM](#)

REPRESENTATIVE WILSON asked the witness what the effect of the bill would be on his company's Alaska activities.

MR. MACKINNON replied that he would not "fold it all up" but he would direct his money elsewhere due to higher costs, environmental issues, and state permitting requirements. He noted that in other areas, such as Nevada, it is much easier to get to mining sites.

[9:45:06 AM](#)

REPRESENTATIVE SEATON asked whether Mr. MacKinnon does any exploring on AMHTA lands or native lands.

MR. MACKINNON replied not generally, and noted that with AMHTA lands, he still has to work with a state organization. For native land, he said that "things will not change in the middle

of the game" and indicated that there are fewer regulatory obstacles to exploration.

[9:45:54 AM](#)

CHAIR HAWKER asked whether the state's regulatory authority extends to operations on native owned land.

MR. MACKINNON agreed that the state's regulatory powers applies to operations on non-state land, but said that there is a difference between land one owns and land one leases, and indicated there is more freedom with land owned rather than leased.

[9:46:35 AM](#)

REPRESENTATIVE SEATON asked whether requiring net smelter return will harm exploration on state land even when landowners other than the state currently collect royalties based on net smelter return.

MR. MACKINNON replied that the state sets royalty rates in statute, while royalties with private landowners can be negotiated based on the actual circumstances. He opined that because of this, the state should set the royalty requirements "at the lowest common denominator," or take some other action to reduce the risk that mining operators will have to pay royalties on unsuccessful operations.

[9:48:00 AM](#)

REPRESENTATIVE SEATON clarified that if there is no production, there is no royalty based on net smelter return.

[9:48:27 AM](#)

CHARLIE BODDY, Vice President, Governmental Relations, Usibelli Coal Mine, Inc., referred to the Hellenthal poll and said that it is related to Northern Dynasty Inc.'s proposed Pebble project and "speaks nothing to the mining industry" as a whole. He also cautioned the committee not to compare the mining industry with the oil and gas industry as these industries operate under totally different scenarios. He noted that the coal industry pays many taxes and fees that other industries do not pay. He went on to say this year's bill has not significantly changed from that proposed last year. Last year his company calculated that the proposed changes would cost it an additional \$500,000.

He said Usibelli is currently producing about one and one-half million tons of coal annually, with half of that production being used in state; the other half is exported to Chile and South Korea. He described these "fragile" contracts as based on a price per ton basis. He explained that any additional "pennies per ton" add up and become a significant factor.

[9:50:50 AM](#)

MR. BODDY said if one looks at past mining tax revenues there are years where the state did not receive much in taxes, but that there are factors to consider besides taxes because the state does not contribute capital to mining development. He referenced mining operations of Red Dog Mine and Fort Knox as currently providing some tax revenue to the state. He went on to say that in his opinion, the Fraser report is a good indicator of how mining companies view Alaska for development. He reminded the committee that despite the fact that Alaska has the majority of coal reserves in the United States, there is only one coal mine in the state. He opined that perhaps the reason for lack of development of coal reserves was based in part on the remote location of most mining sites. Furthermore, he referenced that the state lacks some resources available in other states, such as reports on air and water quality and climatology. These studies must then be done at the mining company's expense and at tremendous cost, he said. He said that mining support industries are significant throughout the life of a mining project. He explained that the coal industry pays a federal reclamation tax of \$0.35 a ton and for employee medical costs incurred by coals mines that are no longer in operation. He emphasized that the bill could cost Usibelli over \$500,000 and that in the coal industry, "pennies make a difference."

MR. BODDY clarified that currently the coal industry does not pay royalties based on 5 percent of adjusted gross income, but pays based on 5 percent of adjusted gross value.

[9:56:52 AM](#)

REPRESENTATIVE ROSES asked what the cost would have been to Usibelli under the mining tax bill proposed last year.

MR. BODDY replied it would have cost his company an additional \$500,000 to \$600,000 a year.

[9:57:55 AM](#)

REPRESENTATIVE SEATON clarified that the aforementioned cost increase would be for mining license net income taxes due, not for royalty or rent obligations.

MR. BODDY agreed that the increase would be for the mining license tax as the existing leases would be held harmless from any price increase. In response to a question, he explained that coal mine lease lengths vary, but that domestic contracts are normally for 5 to 10 year periods, while export contracts used to be for 10 years, but are now anywhere from 1 to 3 years in length. He further responded by explaining that that many of the contracts allow the company to "pass through" cost and tax increases, but said that, as a practical matter, a cost increase could result in the company losing the contract.

[9:59:34 AM](#)

REPRESENTATIVE SEATON clarified that the aforementioned comment relates to sales contracts with buyers, not to leases of state land.

[10:00:01 AM](#)

MR. BODDY said he believes that any contracts Usibelli currently holds with state entities, such as the Alaska Railroad Corporation, cannot be changed until the contract adjustment period.

[HB 156 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at [10:01:57 AM](#).