

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

March 23, 2007

7:44 a.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Representative Bob Roses

**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
03/16/07	(H)	Heard & Held
03/16/07	(H)	MINUTE(W&M)
03/21/07	(H)	W&M AT 7:30 AM HOUSE FINANCE 519
03/21/07	(H)	Heard & Held
03/21/07	(H)	MINUTE(W&M)
03/23/07	(H)	W&M AT 7:30 AM HOUSE FINANCE 519

**WITNESS REGISTER**

JOHANNA BALES, CPA, Excise Audit Manager  
Tax Division

Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 156.

KERWIN KRAUSE, Mineral Properties Manager  
Division of Mining, Land and Water  
Department of Natural Resources (DNR)  
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 156 and mining issues.

ED FOGELS, Deputy Commissioner  
Department of Natural Resources  
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 156 and mining issues.

STEVEN C. BORELL, P.E., Executive Director  
Alaska Miners Association, Inc.  
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 156.

#### **ACTION NARRATIVE**

**CHAIR MIKE HAWKER** called the House Special Committee on Ways and Means meeting to order at [7:44:45 AM](#). Present at the call to order were Representatives Hawker, Fairclough, Wilson, Cissna, Seaton, and Gruenberg. Representative Roses was excused.

[7:46:23 AM](#)

#### **HB 156-MINING PROD. & LICENSE TAXES/ROYALTIES**

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."

[7:46:44 AM](#)

REPRESENTATIVE SEATON offered Amendment 1 which read [original punctuation provided]:

Page 2, lines 8-9, following "lease;":  
Delete "the annual rental shall be effective for a  
period of not more than 20 years;"

Insert "[THE ANNUAL RENTAL SHALL BE EFFECTIVE FOR A PERIOD OF NOT MORE THAN 20 YEARS;]"

Page 6, line 8, following "determining the"  
Delete "tax"  
Insert "production royalty"

Page 7, line 24, following "of"  
Delete "exemption"  
Insert "**deferral** [EXEMPTION]"

CHAIR HAWKER objected for purpose of discussion.

REPRESENTATIVE SEATON explained that Amendment 1 contains three technical amendments. The first part removes from statute the language that leases shall be effective for a period of not more than 20 years. The second inserts a reference to "production royalty," and the third deletes a reference to "exemption" and inserts "deferral," so as to be consistent with other sections of HB 156.

[7:48:14 AM](#)

CHAIR HAWKER removed his objection, and there being no further objection, Amendment 1 to HB 156 was adopted.

[7:48:46 AM](#)

REPRESENTATIVE SEATON moved offered Amendment 2 which read [original punctuation provided]:

Page 3, line 9, following "shall be"  
Delete "**not less than \$3.30 for each acre**"  
Insert "**not less than \$1.65 for each acre during the first five years of a lease and not less than \$3.30 for each acre after the first five years of a lease**"

Page 7, line 25 through page 8, line 4:  
Delete all material and insert:

\* **Sec. 12.** AS 43.65.010(c) is amended to read:  
"(c) The license tax on mining is imposed on the net income of the taxpayer from the property in the state, computed with allowable depletion, plus royalty received in connection with mining property in the state. The tax rates applicable to the amount of a taxpayer's net income are as follows:

over \$100,000 and not over \$250,000.....5 percent  
over \$250,000 and not over \$500,000.....\$7,500  
plus 7 percent of the excess over \$250,000  
over \$500,000 and not over \$1,000,000.....\$25,000  
plus 9 percent of the excess over \$500,000  
over \$1,000,000.....\$70,000  
plus 11 percent of the excess over \$1,000,000."

Page 9, line 9, following "federal":  
Insert "or state"

CHAIR HAWKER objected for purposes of discussion.

[7:49:27 AM](#)

REPRESENTATIVE SEATON explained that the first part of Amendment 2 on page 3, line 9, institutes a rental fee on metal mines of not less than \$1.65 an acre for the first five years of a lease. The rent adjusts to a base level of not less than \$3.30 an acre after the first five years of a lease. The second part of the amendment affects page 7, line 25 through page 8, line 4, and elevates the net income necessary to trigger application of the mining license tax from \$40,000 to \$100,000. It sets forth the following tax brackets: \$100,000 to \$250,000; \$250,000 to \$500,000; \$500,000 to \$1 million, and over \$1 million in net mining income. He stated that Amendment 2 conforms to previous presentations to this committee.

CHAIR HAWKER observed that a "Non-renewable Resource Tax Comparison Chart" which compares the current mining tax and royalty provisions with those proposed under the bill had been provided to the committee.

REPRESENTATIVE SEATON went on to explain that the amendment to HB 156, page 9, line 9 is to assure that there is no deduction of the mining license net tax from another net tax. Amendment 2 clarifies that neither net federal or state taxes can be deducted from the mining license tax.

[7:51:08 AM](#)

JOHANNA BALES, CPA, Excise Audit Manager, Tax Division, Department of Revenue (DOR), agreed that table chart titled "HB 156 - Proposed Changes to Mining License Tax Rates" contains calculations of the mining license tax under the provisions of Amendment 2 offered by Representative Seaton. She stated in

response to a question that she has had the opportunity to review Amendment 2 and that she is comfortable that the proposed changes would exempt from taxation the first \$100,000 of net mining income even if the taxpayer's income went over \$100,000.

CHAIR HAWKER clarified that the first \$100,000 of income is exempt from taxation under the proposed marginal tax rate structure of Amendment 2.

[7:52:40 AM](#)

REPRESENTATIVE SEATON agreed that the aforementioned characterization correctly describes his intent. He explained that the tax rates under the proposed bill and the current system equalize at the point of \$850,000 in net mining income. Under the current and proposed scenario, a taxpayer with \$850,000 in net mining income would owe \$56,500. When net mining income is below \$850,000, the provisions in the proposed bill will result in a lower tax rate for the mine operator. When net mining income is over \$850,000, the taxpayer would pay more under the provisions of the bill. For example, when a taxpayer's net mining income is \$5 million, the taxpayer would owe \$347,000 under the current tax structure, but would owe \$510,000 under the tax rates proposed in the bill, he explained.

[7:55:51 AM](#)

CHAIR HAWKER conveyed his understanding that Amendment 2 proposes a lesser tax obligation for mines with less than \$850,000 in taxable income, and proposes to impose, to a varying degree, a higher tax obligation for those with more than \$850,000 of taxable mining income.

REPRESENTATIVE SEATON agreed with the aforementioned description.

[7:56:23 AM](#)

REPRESENTATIVE WILSON requested more information in graph form regarding the bill's effect on tax rates.

[7:57:14 AM](#)

CHAIR HAWKER removed his objection to Amendment 2, and there being no further objection, Amendment 2 was adopted.

[7:57:54 AM](#)

REPRESENTATIVE GRUENBERG suggested that small mining operations be notified of the tax break provided by the bill. Furthermore, he would like to know the net effect of the bill on the state's tax revenues from mining.

7:58:50 AM

REPRESENTATIVE SEATON acknowledged the benefit of providing information to those affected by the proposed bill, but pointed out that until an amended bill is adopted and moved from committee, the only version available to the public is the bill's former version. He noted that the public can get information by listening to committee proceedings and stated that his office is working to inform interested persons of the changes wrought by the proposed amendments.

8:00:45 AM

CHAIR HAWKER said that he would appreciate a chart that details the tax effects of the proposed bill. He recalled that in a prior hearing, Ms. Bales estimated that 166 taxpayers currently file mining license tax returns and requested that DOR provide information regarding how the bill would affect small and large mining operations.

MS. BALES replied that she has prepared a fiscal note incorporating the effects of Amendments 1 and 2 and it has been transmitted to the committee. She stated that her review of the proposed amendments concludes that the revenue projections under the bill would be very close to those in the original fiscal note prior to adoption of Amendments 1 and 2. She went on to say that based on tax data from fiscal years 2005 and 2006, the bill would increase the mining license tax for approximately 5 of the 166 taxpayers that file mining license tax returns.

8:05:41 AM

CHAIR HAWKER asked how the proposed changes may apply to upcoming, but not currently producing, mining operations.

MS. BALES replied that determination is a bit more difficult, but that DOR is currently working with its economists on this issue.

8:06:38 AM

REPRESENTATIVE CISSNA asked how many mining leases may exist for smaller mining operations and how much time and investment mining leaseholders must spend to maintain their claims.

[8:09:53 AM](#)

KERWIN KRAUSE, Mineral Properties Manager, Division of Mining, Land and Water, Department of Natural Resources (DNR), explained that there are about 35,000 active mining claims on state land, with about 110 leases. Lease holders are required to annually perform at least \$100 worth of work for every 40 acres of claim area. Claim holders must also pay a rental fee. The requirements of the mining license tax and royalty obligations are triggered when a claim begins production.

[8:11:08 AM](#)

REPRESENTATIVE CISSNA asked which of these claim holders are required to file a mining license tax return.

MR. KRAUSE explained that there are approximately 200 small placer mining operations in the state. He estimated that 125 of those operations would have mining activity that triggers the need to file mining license tax and royalty returns. He estimated that most small miners have income of less than \$100,000.

REPRESENTATIVE SEATON stated he will request that DOR set forth the mining tax obligations as proposed by the bill in various income categories.

[8:14:42 AM](#)

REPRESENTATIVE WILSON noted that although the bill may provide a tax break for smaller mine operations, the larger mines provide support for smaller mine operations. She expressed concern that too large of a tax increase on larger mines may hamper development in the state.

[8:17:30 AM](#)

REPRESENTATIVE FAIRCLOUGH asked whether there is any relationship between DNR's mining oversight activities and the filing of a tax return. She questioned whether the proposed changes to the mining license tax would lessen DNR oversight of mining operations.

[8:18:19 AM](#)

ED FOGELS, Deputy Commissioner, Department of Natural Resources, replied that there is not really any relationship between a mine's income level and DNR inspection efforts. He said that DNR will inspect mines in the exploration stage as well as those that are in the production stage. In response to a further question, he explained there are approximately 1,000 claim holders for the 35,000 claims in the state. He noted that many claim holders hold more than one claim and that some of them may hold "thousands of claims." He went on to say there are about 200 permitted and producing mine sites, and that DNR annually inspects as many as possible. He said DNR visits large mines at least once a calendar year quarter, or even more frequently. Smaller operations tend to be grouped in certain areas, such as the Forty Mile area near Fairbanks, and that mining operations staff visit as many mines as possible during the summer.

[8:21:08 AM](#)

MR. KRAUSE estimated that DNR inspects about half of the smaller mine operations each year.

[8:21:21 AM](#)

REPRESENTATIVE FAIRCLOUGH sought further information as to how DNR classifies mines as either big or small if not based on revenues and the filing of a tax return.

MR. FOGEL explained that the state has many small placer mine operations with under \$100,000 in annual income. From that level, there is a jump to very large operations such as the Green's Creek, Red Dog, and Fort Knox mines.

REPRESENTATIVE FAIRCLOUGH reiterated her opinion that it appears that inspections are based in part on mining revenue and therefore it appears that DNR focuses attention on the larger mines.

MR. FOGEL agreed that DNR focuses most of its attention on the larger, more complex mining operations.

[8:23:34 AM](#)

REPRESENTATIVE FAIRCLOUGH stated she supports policy development to increase employment opportunities for Alaskans, but would like further clarification as to whether proposed changes in

taxation could have an adverse effect on regulatory oversight of mining operations.

MR. KRAUSE replied that he does not think the proposed change in the mining tax will make a difference in DNR's mining oversight activities. He said that DNR has had one section that focuses on larger mines, while another section focuses on smaller operations. He explained that other resource agencies, such as the Office of Habitat Management & Permitting in DNR, the Alaska Department of Fish & Game, the Department of Environmental Conservation, the federal Environmental Protection Agency, and the United States Army Corps of Engineers also have oversight of mining activities.

[8:25:54 AM](#)

REPRESENTATIVE SEATON clarified that the first version of the bill proposed to excuse some operations from filing mining license tax returns. He eliminated that exemption from the proposed bill after discussions with DOR because every mining license holder must file a mining license tax return each year to renew their mining license and he did not want to disturb that system. He explained that the current and proposed tax is based on a net income determination, and that even a large operation could have no net income.

[8:27:07 AM](#)

REPRESENTATIVE CISSNA asked whether small mining operations tend to be seasonal, while larger mines tend to work year round.

MR. FOGELS replied that many small operations are seasonal, and will operate from time of the spring thaw until the onset of winter. He said that larger operations tend to operate year round.

[8:30:35 AM](#)

REPRESENTATIVE SEATON reminded the committee that the mining license tax is only one part of the mining tax regime. Mine operators are also required to pay rents, royalties, and corporate income tax. Due to these many factors, it may be difficult to prepare a chart that integrates the various tax regimes with the proposed changes, such as the change to net smelter return to determine royalty payments owed.

[8:31:57 AM](#)

CHAIR HAWKER observed that the bill covers three major components: the mining license tax, royalty payments, and rents. It proposes a major change in the calculation of royalty payments on metal mines from 3 percent of net income, to 3 percent of net smelter return. He observed that royalty payments may be contractual and asked whether the proposed changes would affect existing lease terms between claim holders and the state.

REPRESENTATIVE SEATON said he believes the royalty payment obligations are contractual, and that he could provide further information on the bill's affect on existing leases.

MR. FOGEL said it is his understanding that the bill would increase the royalties for all miners. In response to a question, said he believes that any change in the royalty provisions would affect all existing operations. He agreed that DNR administers royalty provisions, while DOR administers the mining license tax.

[8:33:56 AM](#)

CHAIR HAWKER asked whether DNR could estimate the effect of the bill on the state's royalty revenues for both large and small mines.

MR. FOGEL replied that the DNR's initial fiscal note estimates an royalty increase of about \$3.5 million for FY 08, and that his agency is working to refine those calculations.

[8:35:30 AM](#)

REPRESENTATIVE FAIRCLOUGH asked Representative Seaton if he could incorporate all three components-mining license tax, rents, and royalties-and show the impact of the proposed changes to each individual component as well as the impact of the bill as a whole.

REPRESENTATIVE SEATON indicated that while he would attempt further graphing of the proposed changes, there are difficulties with integrating the changes into one chart. He reminded the committee that the mining license tax is calculated on net profits, but the bill proposes to calculate royalties due on net smelter return. He also noted difficulties with predicting net income for mining operations because so many factors work to determine net income.

8:37:36 AM

REPRESENTATIVE FAIRCLOUGH suggested that it may be useful to review actual mining revenues from FY 05 and calculate the bill's effects on those revenues as a way to compare the current mining tax laws to the proposed changes.

REPRESENTATIVE SEATON reminded the committee that individual taxation information is confidential, but that he could get aggregate figures from DOR to provide further comparisons for the committee.

8:39:03 AM

CHAIR HAWKER said he understands the difficulties of forecasting the bill's effect, but that he supports the efforts to present the bill's effect on large and small mines in an accurate and understandable manner.

8:40:03 AM

REPRESENTATIVE SEATON agreed that mine operations pay mining license taxes, rents, royalties, and corporate income taxes. He reminded the committee that the state does not receive royalties for mining operations on non-state land. Therefore any predictions about the bill's effects will not include rents and royalties paid to federal or private landowners. Furthermore, corporate taxes are not changed by this bill.

MR. FOGEL responded to a question by explaining that of the state's five biggest mines, the Pogo Gold Mine and Usibelli Coal Mine are the only ones on state land.

8:43:35 AM

STEVEN C. BORELL, P.E., Executive Director, Alaska Miners Association, Inc., opined that any model of the bill's effects would need to include more than the mining license tax because the bill has several pieces to it. He expressed concern over the proposal to charge royalties based on net smelter return, which he described as "a gross royalty." He indicated that royalties charged on some private lands may be around one and one-half to two percent. He explained that with private landowners, a mine's operator can negotiate with the landowner to arrive at an acceptable royalty figure, but that kind of negotiation cannot happen if a royalty rate is set in statute.

He also expressed concern with the proposed changes to depletion allowances. The situation is further complicated because precious metals, such as gold, should be considered differently from other base metals, he opined. He said that a few years ago, most mines were losing money and it is only recently that mineral prices have risen.

[8:49:44 AM](#)

CHAIR HAWKER said he is troubled by the proposal to eliminate the percentage depletion deduction from the mining license tax. He also set forth for the committee's consideration that there are provisions in the oil and gas tax regime whereby a taxpayer can petition DNR for royalty relief in some situations.

[8:51:11 AM](#)

MR. BORELL noted that while the ability to negotiate royalty payments may work once a company is in operation, it is not so helpful for a mining operation still in the exploration stage. He explained that because of uncertainties in the outcome of any royalty negotiations, a mining operator may use a conservative approach and evaluate a project based on the highest royalty percentage that could be imposed. He opined that this could stop development of projects at a very early stage. He reminded the committee that medium and large mining companies often do a "bankable feasibility study" to determine whether to proceed with a large project.

[8:53:52 AM](#)

REPRESENTATIVE CISSNA asked what could be done to make the proposed legislation more acceptable to the mining industry and yet still provide some additional revenues for the state.

MR. BORELL replied that in his opinion, the two most disturbing parts of the bill are elimination of percentage depletion allowance and the imposition of royalties based on net smelter return. He went on to say that there is very little infrastructure to support mining in the state, and that mining provides the state with a great deal of infrastructure. He noted that in Juneau the first electricity generated was due to mining activities. Today mines are still building infrastructure, such as roads, airstrips, and power lines, he opined.

[8:59:15 AM](#)

REPRESENTATIVE CISSNA observed that the state is responsible for much infrastructure, and asked whether infrastructure development is deductible from net income, therefore deductible from the determination of net smelter return.

MR. BORELL agreed that the state has provided some infrastructure, but that there are still many areas in the state that lack road access.

[9:01:12 AM](#)

CHAIR HAWKER answered a question by explaining that a marginal tax structure means that as income increases, further earnings are taxed at the next tax bracket. For example, under the bill as amended, the first \$100,000 of mining income is not taxed. However, income over \$100,000 but under \$250,000 is taxed at 5 percent. He emphasized that the marginal tax on every dollar of income under \$100,000 is zero and is not subject to taxation regardless of whether there is income over \$100,000.

[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 [9:05:02 AM](#).