ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

September 9, 2021
3:38 p.m.

MEMBERS PRESENT

Senator Joshua Revak, Chair
Senator Peter Micciche, Vice Chair
Senator Click Bishop
Senator Gary Stevens
Senator Natasha von Imhof
Senator Jesse Kiehl
Senator Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Cronk

COMMITTEE CALENDAR

SENATE BILL NO. 3002
"An Act establishing an income tax on certain entities in the state; relating to the motor fuel tax; relating to nontransferable tax credits against the oil and gas production tax; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 3002
SHORT TITLE: TAX: MOTOR FUEL, CORP. INCOME, O&G
SPONSOR(s): SENATOR(s) BEGICH

09/01/21	(S)	READ THE FIRST TIME - REFERRALS
09/01/21	(S)	FIN
09/02/21	(S)	RES REFERRAL ADDED BEFORE FIN
09/09/21	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

SENATOR TOM BEGICH
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Sponsor of SB 3002.

MERCEDES COLBERT, Staff
Senator Tom Begich
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Presented the sectional analysis for SB 3002 on behalf of the sponsor.

EMILY NAUMAN, Attorney
Legislative Legal Services
Legislative Affairs Agency
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Answered questions during the hearing on SB 3002.

COLLEEN GLOVER, Director
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Co-presented the overview of Alaska's taxes on motor fuels, corporate income, and per barrel credits.

NICOLE REYNOLDS, Deputy Director
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Co-presented the overview of Alaska's taxes on motor fuels, corporate income, and per barrel credits.

JHONNY MEZA, Commercial Section Manager
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska
POSITION STATEMENT: Co-presented the overview of Alaska's taxes on motor fuels, corporate income, and per barrel credits.

DAN STICKEL, Chief Economist
Tax Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Answered questions and provided information during the overview of Alaska's taxes on motor fuels, corporate income, and per barrel credits.

ACTION NARRATIVE

3:38:37 PM

CHAIR JOSHUA REVAK called the Senate Resources Standing Committee meeting to order at 3:38 p.m. Present at the call to order were Senators Stevens, Kawasaki, Kiehl, Von Imhof (via teleconference, Micciche and Chair Revak. Senator Bishop arrived shortly thereafter.

SB 3002-TAX: MOTOR FUEL, CORP. INCOME, O&G

3:39:46 PM

CHAIR JOSH REVAK announced the consideration of SENATE BILL NO. 3002 "An Act establishing an income tax on certain entities in the state; relating to the motor fuel tax; relating to nontransferable tax credits against the oil and gas production tax; and providing for an effective date."

3:41:02 PM

SENATOR TOM BEGICH, Alaska State Legislature, Juneau, Alaska, stated that SB 3002 seeks to establish an income tax on certain entities relating to a motor fuels tax and a nontransferable tax credit against the oil and gas production tax. He stated that the Fiscal Plan Working Group of 2021 was historic because two members from the House Majority, House Minority, Senate Majority, and Senate Minority worked together to create a bipartisan revenue plan. The plan received widespread support from the public, administration, and legislators.

SB 3002 addressed a portion of the working group's revenue plan by increasing revenue from three sources. He expressed a desire for SB 3002 to move to the next committee of referral since the Senate previously heard or passed the proposals in the bill.

3:44:30 PM

Using the estimates assumed by the working group, SB 3002 would increase revenue by $195 million; $110 million would come from the change to the per barrel tax credit structure, $18 million from the motor fuel tax adjustment, and $67 million from the expansion of corporate income tax structure to capture excluded entities.

3:45:06 PM

SENATOR BEGICH opined there is a need for a revenue bill to advance to the finance committee for exploration.

He said the oil and gas industry will object to SB 3002 claiming lack of competition and that additional taxation will be harmful. Yet, Alaskan citizens have contributed $2 billion a year of expected permanent fund dividend income over the past five years.

SENATOR STEVENS asked how much revenue would come from taxing S corporations.

SENATOR BEGICH answered $67 million in the first year.

3:47:21 PM
MERCEDES COLBERT, Staff, Senator Tom Begich, Alaska State Legislature, Juneau, Alaska, presented the sectional analysis for SB 3002 on behalf of the sponsor:

> Section 1: Adds a new section to the Alaska Net Income Tax Act. This section establishes a new tax of 9.4 percent for certain corporations earning at least $4 million on qualified net taxable income. This tax applies to sole proprietorships, partnerships, or federally defined S and C corporations, not publicly traded.

SENATOR BEGICH interjected that a company with net income of $4.1 million would pay 9.4 percent tax on the amount above $4 million, which would be $100,000.

SENATOR REVAK asked how the $4 million threshold was determined.

SENATOR BEGICH responded that the $4 million cut-off came from proposed legislation from Senator Wielechowski.
MS. COLBERT added that the legislation set the $4 million amount with a specific entity in mind.

SENATOR VON IMHOF questioned why the percentage rate jumped from 0 to 9.4 percent.

3:49:58 PM
SENATOR BEGICH responded that 9.4 percent mirrors existing legislation for corporate income tax, which stair-steps up to 9.4 percent for companies earning over $220,000 in net profits. The threshold is set at $4 million for S corporations to avoid

hurting mom-and-pop businesses. Some corporations chose to be S corporations and avoid Alaska's state corporate tax.

SENATOR BEGICH stated that British Petroleum divested itself of assets in Alaska to an S corporation. Previous legislation tried to recapture the lost $40 million in corporate income tax revenue and remedy the loophole.

SB 3002 would begin taxing S corporations only on net profits exceeding $4 million.

3:52:19 PM
SENATOR STEVENS asked if individuals who own S corporations pay income tax instead of corporate state tax and what the rate is.

SENATOR BEGICH replied that owners of S corporations pay income tax if the state has an income tax. An S corporation owner does not pay individual state income tax in Alaska.

SENATOR STEVENS commented that the $40 million in lost revenue is truly a loss.

SENATOR BEGICH replied, correct.

3:53:47 PM
SENATOR VON IMHOF expressed concern that a particular company is being targeted for taxable revenue. She asked for the definition of the term "qualified taxable income" in Section 1(c).

SENATOR BEGICH responded that Emily Nauman would answer the question. He commented that the loss of $40 million highlighted a flaw in Alaska's revenue system. When drafting SB 3002 with Legislative Legal Services (Leg Legal), the goal was to close the loophole without destroying mom-and-pop businesses; that threshold was $4 million. He opined that upstanding corporate companies willingly contribute to the state's corporate infrastructure.

3:55:48 PM
SENATOR REVAK requested that questions for [Leg Legal] be held until after the presentation. He asked the sponsor to confirm that the tax applies to S corporations, LLCs, partnerships, and other entities making over $4 million in net income.

SENATOR BEGICH replied, correct. It also includes sole proprietors.

3:56:34 PM
MS. COLBERT resumed reading the sectional analysis

> Section 2: Increases the surcharge from $0.0095 per gallon to $0.015 per gallon on refined fuel sold, transferred, or used in Alaska.
>
> Section 3: Increases the tax on motor fuel sold or transferred within the state from $0.08 to $0.16 per gallon. This section also increases motor fuel sold and transferred for the use in and on watercraft from $0.05 cents to $0.10 per gallon.
>
> Section 4: Increases the tax on motor fuel consumed from $0.08 to $0.16 per gallon. This section also increases the tax on motor fuel consumed for the use in and on watercraft from $0.05 cents to $0.10 per gallon.
>
> Section 5: Amends AS 43.40.030(a), relating to the refund of the motor fuel tax for non-highway use, by increasing the fuel tax refund from $0.06 to $0.12 per gallon for internal combustion engines. Adds a $0.05 per gallon refund eligibility for commercial fishing watercraft.

3:58:04 PM
SENATOR MICCICHE stated that with the increased use of electric vehicles (EV) nationwide, there has been an increase in tax legislation aimed at capturing revenue from EV use to pay for highway maintenance. He asked if that was considered in SB 3002.

SENATOR BEGICH answered that tax on EVs was considered in the original motor fuels bill. It is not included in SB 3002 because Leg Legal advised it might lead to a single subject rule violation. He said he is willing to support standalone legislation on an EV tax but does not want to risk the integrity of SB 3002 by including it.

SENATOR REVAK asked why there is an exemption for commercial fishing vessels and how much it would be.

4:00:13 PM
SENATOR BEGICH stated that Leg Legal might be able to provide the amount of the exemption. He said commercial fishing vessels were exempted because they were exempted in

the bill from which it was drafted. The motor fuels tax portion of SB 3002 is taken from the final House version of Senate Bill 115.

4:00:58 PM
MS. COLBERT continued reading the sectional analysis:

> Section 6: Amends AS 43.55.024(j), relating to nontransferable oil production tax credits. This section repeals the $8, $7, and $6 per barrel tax credits, effectively capping the per barrel tax credit at $5 per barrel if the average gross value at the point of production for the month is less than $110 per barrel.
>
> Section 7: Applies the new corporate income tax established in section 1 of this bill to the tax year beginning on or after January 1, 2022. 32-LS1152/B| 9.9.2021 | 2
>
> Section 8: Transition language for the Department of Revenue to adopt regulations necessary to implement this bill if passed into law. Regulations may not take effect before January 1, 2022.
>
> Section 9: Immediate effective date for the Department of Revenue to begin work on regulations as authorized under Section 8.
>
> Section 10: Except for Section 9, this bill takes effect January 1, 2022

4:02:06 PM
SENATOR BEGICH added that his hope is that the finance committee makes passage of SB 3002 contingent upon legislation relating to a change in the dividend statute.

CHAIR REVAK asked if the purpose of SB 3002 is to increase the permanent fund dividend.

SENATOR BEGICH replied that the purpose of SB 3002 is to ensure the state has an acceptable comprehensive fiscal plan. The fiscal plan working group identified that a plan must include a constitutional percent of market value, finality to the dividend question, revenue for a balanced budget, and spending review. SB 3002 addresses two elements suggested by the working group.

Legislators must be willing to make painful changes if they are serious about establishing a state fiscal plan.

4:04:03 PM
SENATOR MICCICHE asked if the surcharge increase from $0.95 per gallon to $1.05 in Section 2 was calculated to capture the Spill Prevention and Response (SPAR) funding gap and if the Department of Environmental Conservation (DEC)supports it.

SENATOR BEGICH answered that it does meet the amount discussed in the DEC subcommittee meeting. He does not know DEC's position but his belief is that the department was in support of the increase.

SENATOR KIEHL commented that it seems counterintuitive that Section 6 proposes deleting the per barrel tax credit at lower net oil prices but keeps them at higher net oil prices. He asked why this approach was taken and if he would be receptive to the existing approach.

SENATOR BEGICH stated he is amenable to change and explained that the approach in SB 3002 was selected because it seemed less damaging to the oil industry. Garnering less opposition from the oil industry is favorable to the state. The proposal was an attempt to compromise. He stated his preference for a property tax on oil company land use because it would net more revenue and be stable. However, the idea of a property tax met opposition from the oil industry. He stated his desire for the legislature to find the least painful means to compromise.

SENATOR VON IMHOF asked what evaluation was done to determine that the oil tax credit proposal in SB 3002 would be less damaging to the oil industry, aside from comparing it to Senator Wielechowski's bill, which eliminates all tax credits.

4:07:33 PM
SENATOR BEGICH replied that Senator Wielechowski's bill was the comparison. It is more damaging to the oil industry to provide zero tax credits than some tax credits.

The goal of SB 3002 is to initiate solutions to state revenue needs. Any bill that adds an industrial tax burden will be viewed unfavorably by the industry. Likewise, a reduction in the dividend check will damage the individual. The comprehensive fiscal plan was designed in the spirit of compromise to get the legislature discussing revenue.

When discussing an overall fiscal plan, there must be a revenue element, or it is not a fiscal plan. If legislators are serious about doing a comprehensive plan, it must have revenue. SB 3002 was designed to get members into a discussion on revenue. He said he is hopeful members will move SB 3002 to the finance committee for further analysis.

4:09:25 PM
SENATOR VON IMHOF surmised that SB 3002 was not economically evaluated to determine its potential effect on Alaska's investment in the North Slope, which is the largest employer in the state and provides competitive jobs.

She opined that revenue would not be addressed until the permanent dividend issue was solved. The state needs to know how revenue will be spent in order to have a comprehensive fiscal plan. Large dividends should not be paid at the exclusion of Alaska's needs.

4:10:51 PM
SENATOR BEGICH responded that passing SB 3002 is contingent upon the dividend statute being changed. All measures need to be considered simultaneously. He opined that an overall fiscal plan could not be achieved if revenue discussions on industry continue to be delayed.

He agreed that the oil industry is critically important to the state; however, the fishing industry is the largest employer. The next largest is the State of Alaska, followed by local government. The largest single private employer may be the oil industry regarding salaries earned. Yet, many employees do not live in Alaska, which results in uncaptured revenue. A state income tax would not necessarily capture this revenue if passed. He reiterated that SB 3002 is trying to balance resources and interests for individuals and industries. It is an all-inclusive bill where everyone pays something.

He stated that the issues of revenue and dividend change had been discussed and debated. There will be no definitive answer if the legislature does not address them simultaneously. He recognized that members want to defend their interests. Still, he implored them to consider revenue alongside dividend change to achieve a comprehensive fiscal plan for the benefit of the state.

4:13:35 PM

CHAIR REVAK commented that the $4 million threshold is not difficult to achieve for many businesses. He asked if industries or businesses other than fishing were considered for exemption.

4:14:21 PM
SENATOR BEGICH replied that members could adjust the $4 million threshold, although constituents expressed concern about taxes affecting small businesses. He reiterated that the tax is on net income above $4 million, not gross income.

He stated the portion of SB 3002 dealing with a motor fuel tax is the same language used in a bill that passed the Senate and stood a good chance of passing the House but for the interruption caused by COVID.

SENATOR BEGICH called SB 3002 a plagiarist's bill since it is comprised of previously heard bills that had broad consensus.

4:16:55 PM
MS. COLBERT began the presentation on slide 3 that shows the legislative history on corporate tax. She noted that many of the concepts have been discussed in the last four or five years. Some bills applied only to S or C corporations, others applied to both, and some applied only to oil and gas companies. Since 2017, five bills have been introduced regarding the S and C corporate income tax loophole. None of the recent bills that are listed have received hearings.

She displayed slide 4 of the more recent history of motor fuel taxes. SB 3002 reflects a bill currently in House finance. She noted that Senate Bill 115 was the only motor fuel tax bill heard during the 31st Legislature. It passed the Senate and came close to passing in the House but was a casualty of COVID-19. During the 30th Legislature, two bills were heard but did not make it to the floor. They were introduced during the 1st Special Session but were not heard. In the 29th Legislature in 2015 and 2016, several bills were heard; House Bill 4001 and Senate Bill 4001 were omnibus tax bills introduced in the 4th Special Session that included taxes on a number of industries. She related that the purpose for listing these bills is to show that taxes have been discussed on the record.

4:19:42 PM
MS. COLBERT turned to slide 5 that lays out the recent legislative history of the per barrel oil production tax credits. She stated that a bill aimed at the per barrel oil tax was introduced during the 32nd Legislature but not yet been

heard. This morning, the House Ways and Means Committee held its first hearing on a bill similar to SB 3002. Senate Bill 129 was introduced in the 31st Legislature but not heard. Changes were passed into law in the 30th Legislature, but per barrel credits were unchanged. A subsequent bill considered changes to per barrel tax credits but did not pass out of House finance. During the 29th Legislature, House Bill 247 considered changes to the per barrel tax credit. Although it passed, the changes were not made. House Bill 326 was referred to House Resources and House Finance but received no hearing. She added that this provides an overview, not a comprehensive bill history.

4:21:13 PM
MS. COLBERT reiterated that SB 3002 uses language from bills introduced in the recent past. It would impose a 9.4 percent net income tax to sole proprietorships, partnerships, S corporations, and C corporations that make at least $4 million in profits.

MS. COLBERT said that the State of Alaska has not changed motor fuel taxes since 1970. She read slide 7:

- When enacted in 1970, $0.08 tax on motor fuel would be worth $0.54 today.
- The average cost of a gallon of gas in the US was $0.36 per gallon in 1970. As of 2021, it is $2.94 per gallon.
- Alaska's fuel tax has lost 85 percent of its purchasing power to help pay for highway, ferry, and harbor maintenance.

MS. COLBERT stated that slide 8 provides a brief history of the motor fuels tax. In 1945 Alaska levied its first motor fuel tax at $0.01 per gallon. In 1970 it established the current rate of $0.08. In 1977 the marine fuel tax was increased to its present value of $0.05 per gallon. In 1994 the aviation tax was changed to $0.047 per gallon, which SB 3002 does not change. In 2015 a surcharge for the oil spill prevention and response (SPAR) fund was established.

4:23:16 PM
MS. COLBERT moved to slide 9 that compares Alaska's motor fuels tax to other states and read:

- Alaska ranks 50th in the nation for highway and marine fuel tax rates.

- Passage of this bill would move Alaska up to 43rd in the nation for highway fuel taxes and remain at 50th for marine fuel taxes.

- The national average for State motor fuel taxes is nearly 26 cents per gallon.

- This bill does not impact aviation fuel. Alaska remains competitive among the lowest in the nation for aviation and jet fuel tax rates.

MS. COLBERT said an outcry occurred when a tax on jet fuel was considered because Anchorage was the fourth or fifth busiest cargo airport. The aviation fuel tax was not considered in SB 3002 to keep Alaska competitive.

4:24:04 PM
MS. COLBERT stated that estimates indicate that Highway fuel revenue would be $29.7 million to $31.4. It would be used to maintain roads and is an account that receives matching federal dollars. Marine fuel would go to the watercraft fuel tax account that is used for water and harbor facilities maintenance, which would be about $5.5 million per year. The refined fuel surcharge goes to the SPAR fund and is about $3.5 million a year. As currently drafted, the total annual increase would be upwards of $40 million a year.

SENATOR BEGICH interjected that total annual revenue would increase from $38.5 million to $40.7 million.

MS. COLBERT said the legislature has discussed AS 43.55.024(j) at length over the past decade. It establishes nontransferable oil production tax credits. SB 3002 would remove the credit caps of $8, $7, and $6 listed in AS 43.55.024(j) (1-4). The established new credit cap will be at $5 per barrel if the average gross value at the point of production (GVPP) for the month is less than $110 per barrel.

4:26:10 PM
MS. COLBERT turned to slide 12 and said the oil tax credit, motor fuels tax, and expanded corporate income tax are estimated to bring in $195 million by fiscal year 2022. That amount is predicted to increase to over $500 million per year by fiscal year 2030. These amounts were determined by the fiscal plan working group who extrapolated figures from the fiscal notes of previous bills.

4:26:47 PM
SENATOR BEGICH asked if there were any questions about the presentation.

SENATOR STEVENS asked what happened to the lost revenue following the passage of Senate Bill 21 in 2013.

MS. COLBERT replied that the Department of Revenue (DOR) would address that question.

CHAIR REVAK requested Leg Legal address questions from the meeting.

4:27:50 PM
EMILY NAUMAN, Attorney, Legislative Legal Services, Legislative Affairs Agency, Alaska State Legislature, Juneau, Alaska, stated her understanding that in Section 1 subsection(c) was designed to avoid gaming subsection (a) that puts a tax on entities having taxable income of $4 million. That subsection was designed to give the Department of Revenue the authority to combine the income of entities that appear to be splitting into smaller units to avoid reaching the $4 million cap.

MS. NAUMAN stated that a low to moderate single subject risk was the reason for not including an electric vehicle (EV) fee in SB 3002. If included, the bill adjoins taxes and fees. In general, fees go to the department they originated from, while taxes are broadly collected and serve the general fund. SB 3002 was drafted to be bulletproof. The entire bill would fail if it fails the single subject test.

4:29:36 PM
SENATOR MICCICHE stated the motor fuels tax bill passed the Senate and advanced partially through the House. The EV portion of that bill was segmented into SB 3002. He asked why there is a single subject issue with SB 3002 but not the bill from which it was drafted.

MS. NAUMAN replied that all sections of the other bill were related to motor vehicles. SB 3002 has provisions about taxes, so the single subject of the bill has changed from motor vehicles to taxes.

4:30:42 PM
CHAIR REVAK recognized that Representative Cronk was in the audience.

4:30:54 PM
SENATOR KIEHL stated he does not recall a distinction in the constitution between taxes and fees. He used the Division of Motor Vehicles as an example of raising more revenue through fees than it uses, which presents the argument that all fees are taxes. He asked if Alaska courts have opined on this distinction and its importance to the single subject rule.

MS. NAUMAN answered that the courts have not opined on that specific distinction. It has been discussed between attorneys and the Leg Legal office. It was omitted from SB 3002 to achieve zero risk of violating the single subject issue.

SENATOR BEGICH stated the intent of excluding an EV tax was to remove the risk of having SB 3002 struck down after passing. He relied on the advice of Leg Legal to avoid the risk. He does not object to changes but cautioned against having a bill struck down for invalidation reasons. He said he supports standalone legislation on EVs.

SENATOR KIEHL commented that it seems unlikely SB 3002 would be struck down under the single subject rule for inclusion of EV fees.

4:33:15 PM
SENATOR BISHOP stated the genesis behind the motor fuels tax has not changed. Roads need to be maintained, but maintenance stations have closed due to a lack of funds. He stated his support of the motor fuels tax has not changed.

SENATOR VON IMHOF stated that fairness seems to be lacking in SB 3002. Entities are excluded from the motor fuels tax, S corporation tax, and per barrel credit rollback. She opined that a lower broad-based tax bill would be better and asked why exemptions were put forward instead.

4:36:16 PM
SENATOR BEGICH stated he favored a state income tax and introduced a broad-based income tax bill that also captures out-of-state income. He welcomes all members to co-sponsor it. However, the governor indicated he would not support an income tax.

SENATOR BEGICH said he would support a broad-based sales tax that exempted clothing and food, but it has not been proposed. Therefore, three previously heard bipartisan bills were combined into one in an attempt to pass the Senate and House with a simple majority. Combining the bills appeared to be the easiest way to obtain passage of a revenue bill and bring resolution to the dividend formula issue.

SENATOR BEGICH reiterated that SB 3002 was not designed to single out any entity. To the extent that it does is a result of the legislative process.

He encouraged members to change SB 3002 or present a broad-based bill that can garner enough support to be passed because time is of the essence. He stated his desire for SB 3002 to receive a fair hearing and be moved to the next committee to receive adjustments.

4:39:30 PM
SENATOR VON IMHOF said the state budget is balanced before paying a dividend. New revenue is only needed to pay a dividend. Therefore, she is opposed to new revenue being paid towards a dividend until the dividend calculation is solved. Alaska has many needs and the assignment of tax revenues should be determinable. The cart is being put before the horse. She stated her belief that the dividend issue needs to be resolved first, and then the needs of the state assessed before discussions about taxes happen.

She opined that SB 3002 is premature, unfair, targeted, and would have significant unintended economic consequences. She is not interested in dissecting or amending a bill where the appropriation of revenue is unknown.

4:41:41 PM
SENATOR BEGICH stated his motivations are purely to solve the problems presented by the fiscal plan working group.

CHAIR REVAK warned against impugning any member's motives.

4:42:28 PM
SENATOR MICCICHE stated he has talked about a tax plan that is low, broad, and as temporary as possible to address Alaska's fiscal situation. He opined that the approach to closing the fiscal gap should be all-inclusive. He acknowledged the intent of SB 3002 as a conversation starter for creating a comprehensive fiscal plan. He stated his belief that the fuel tax is unfair. Commercial fishers receive a $0.05 per gallon holiday on fuel, and aviation is exempt even though Alaska has many airports to maintain. He asked why electric vehicles, the

fishing industry, and the aircraft industry were excluded from the motor fuels section of SB 3002.

4:45:24 PM
SENATOR BEGICH explained that SB 3002 was derived from the last version of the motor fuels tax bill. Aviation fuel was excluded from the original version because, in 2017, there was testimony presented to the House Resources Committee on the direct impact the tax would have on the ability of the Fairbanks and Anchorage airports to be competitive in the world market.

Despite fairness, he reminded members that SB 3002 includes the motor fuels tax bill as it passed in 2020. He does not know what compromises occurred before it reached the Senate floor. There were elements that Senators believed should have been included that were not. He welcomed changes to SB 3002 but cautioned that additions could make the bill less likely to pass. He said he would like the bill to be discussed so that it can be moved.

4:47:32 PM
SENATOR MICCICHE stated he would research competition and its relevance to the aviation fuel tax and other areas of the economy that may be overlooked. He uses state services as a commercial fisherman and is unaware of a reason to be excluded from the tax.

He concluded that low, broad, and as temporary as possible is the approach to use in the development of a fiscal plan. He opined that taxes should be temporary until the growth of the permanent fund improves Alaska's fiscal situation. He added that a motor fuel tax was unlikely to be temporary.

4:49:20 PM
CHAIR REVAK asked if there is research indicating how industries would be affected by imposing the $4 million net income tax threshold.

SENATOR BEGICH replied he is not aware of any studies, but there could have been answers if Senator Wielechowski's bills had been heard. He reiterated that the $4 million threshold is a presupposed number that can be raised. He appreciates members hearing SB 3002.

4:51:26 PM
CHAIR REVAK stated it is important for resource committee members to know a bill's impact on resources.

4:52:01 PM
SENATOR KIEHL commented that the idiom, putting the cart before the horse, does not reflect the process of finding a solution to Alaska's fiscal problem. He opined that the legislature is "nailing together a cart while stitching a harness and teaching the horse to take a bit." He appreciates that members are working to figure out a fiscal solution.

He mentioned S corporations and said he perceives a fairness discrepancy in the oil industry tax structure of SB 3002 because two companies that produce the same resource from the same basin, under the same lease terms, and the same workforce structure pay materially higher taxes than one other company in particular. He asked if that is a fairness issue that needs addressing.

4:53:22 PM
SENATOR BEGICH answered yes. There is an unfair competitive advantage because the income tax requirement is not the same. This scenario applies to any S or C corporation with net profits of $4 million that circumvents its corporate tax obligation. He quipped that Alaska could have all S corporations and a $200 million fiscal gap.

4:54:25 PM
CHAIR REVAK held SB 3002 in committee.

4:55:09 PM
At ease

PRESENTATION: TAX OVERVIEW: MOTOR FUELS, CORPORATE INCOME, AND PER BARREL CREDITS

5:06:05 PM
CHAIR REVAK reconvened the meeting and announced the committee would hear a presentation from the Department of Revenue and the Department of Natural Resources.

5:06:35 PM
COLLEEN GLOVER, Director, Tax Division, Department of Revenue (DOR), Anchorage, Alaska, introduced the presenters and offered to answer questions on the presentation, Tax Overview: Motor Fuel, Corporate Income, and Per Barrel Credits.

5:07:28 PM
NICOLE REYNOLDS, Deputy Director, Tax Division, Department of Revenue (DOR), Anchorage, Alaska, stated slide 3 provides an

overview of the motor fuels tax statutes in AS 43.40 and regulations that interpret the statutes.

She stated that the American Petroleum Institute, Alaska has the lowest combined federal, state, and local gasoline and diesel tax rates. Florida and Pennsylvania have lower fuel excise rates, but both states impose other taxes and fees that bring the amount higher than Alaska. Motor fuel is considered a general tax when sold by qualified dealers. They are responsible for collecting the tax and surcharge then remitting the proceeds to DOR monthly.

5:09:42 PM
MS. REYNOLDS said slide 5 breaks out the total collections for each fuel type and the surcharge from t FY 2017 through FY 2020. The figures were taken from the 2020 Department of Revenue Annual Report. Surcharge proceeds are considered unrestricted general fund revenue. It is set aside for appropriation to the oil and hazardous substance release prevention account. It is intended to benefit the Spill Prevention and Response (SPAR) Division of the Department of Environmental Conservation (DEC).

Tax proceeds are considered designated general fund revenue. The first sixty percent of aviation fuel tax revenue is refunded to local communities that own or operate an airport. The remaining revenue is deposited into the aviation fuel tax account. The legislature may appropriate this money for capital and operating costs of airports. Revenue from the marine fuel tax is deposited into the water fuel tax account in the general fund. The legislature may appropriate this money for water and harbor facilities.

Revenue from motor fuel tax on non-highway vehicles is deposited into the non-public highway use general fund. The legislature may allocate this money to the transportation department for trail staking, shelter construction, and maintenance. All other revenue from motor fuel tax is deposited into the highway fuel tax account in the general fund. The legislature may appropriate this money to the Department of Transportation to maintain and construct highways and ferries.

5:12:05 PM
MS. REYNOLDS read slide 7 that lays out the statutes and regulations that concern corporate income tax in Alaska:

> Corporate Net Income Tax Statutes & Regulations

- AS 43.19 - Multistate Tax Compact Regulations 15 AAC 19.011-.1490
- AS 43.20 - Alaska Net Income Tax Act Regulations 15 AAC 20.010-.920
- 26 U.S.C. 1 - 1399 and 6001 - 7872 Adopted, as amended, by reference in AS 43.20.021(a)

MS. REYNOLDS stated the language "as amended" in the adopted Internal Revenue Code (IRC) Provisions means Alaska adopts any changes to the IRC as they happen. Unless explicitly stated, these IRC provisions have full force and effect unless excepted or modified by other provisions of AS 43.20.

5:13:59 PM
MS. REYNOLDS stated that an entity's Alaska taxable status depends on how they file federally. Only entities that file as C corporations federally are taxable under Alaska corporate income tax provisions. Certain C corporations are exempt from Alaska's corporate income tax. These include certain qualified small businesses with less than $50 million in assets that meet industry requirements and electric and telephone cooperatives paying tax under AS 10.25. Many types of business entities are not subject to Alaska's corporate income tax provisions; examples included S corporations, limited liability companies, partnerships, and sole proprietorships.

5:15:16 PM
CHAIR REVAK asked how many companies would be affected by the tax change proposed in SB 3002.

MS. REYNOLDS replied that the Department of Commerce, Community and Economic Development (DCCED) estimates there are over 20,000 companies. DOR did a limited information estimate and believes SB 3002 would impact less than 900 of those entities.

SENATOR MICCICHE asked if DOR provided the expected revenue amounts given in SB 3002.

MS. REYNOLDS answered no, but Mr. Stickle is available if there are questions about the fiscal note.

5:17:03 PM
MS. REYNOLDS moved to slide 9 and explained that a taxpayer's applicable corporate tax rate is determined by the amount of their net taxable income.

Responding to Senator von Imhof's question, she explained that the entities mentioned in Section 1 of SB 3002 are not currently taxable under state or federal law. Therefore, the term "qualified taxable income" used in subsection (c) would need to be defined.

The maximum tax rate in Alaska is 9.4 percent for taxpayers with taxable income over $222,000. The tax rates were last modified in 1981.

5:18:27 PM
MS. REYNOLDS said the chart Historic Corporate Net Income Tax Collections Summary on slide 9 separates the total collections for oil and gas corporate income taxpayers and non-oil and gas corporate income taxpayers for FY 2017 thru FY 2020. The numbers are from the Department of Revenue 2020 annual report.

Oil and gas corporate income tax collections resulting from assessments are deposited into the Constitutional Budget Reserve Fund (CBRF). All remaining corporate income tax collections are deposited into the general fund.

CHAIR REVAK asked how much is paid out in per barrel tax credits.

MS. REYNOLDS replied that the per barrel credits do not affect corporate income tax and added that Ms. Glover would address the question further in the next portion of the presentation.

5:20:13 PM
MS. GLOVER moved to slide 12 and stated that the per barrel tax credit is a component of the oil and gas production tax. She explained that the governing statutes and regulations for oil and gas production are AS 43.55 and regulations 14 AAC 55.010-.900. The statutes are complicated, and the regulations are extensive. The per barrel tax credits only impact North Slope products. There are two types of credits. Gross Value Reduction (GVR) found in AS 43.55.024(i)--referred to as the (.024(i) credit--is a flat $5 per barrel credit for new production. Non-GVR found in AS 43.55.024(j)--referred to as the .024(j) credit--is for legacy production. It is a sliding scale credit that ranges from $8 to $0 per barrel. SB 3002 impacts this credit type.

5:21:44 PM
CHAIR REVAK asked her to explain how tax credits are paid out.

MS. GLOVER replied that the per barrel tax credit should not be confused with the tax credits that could earn cash that the state bought back. Per barrel tax credits are part of the tax calculation. They are not eligible for cash.

CHAIR REVAK summarized his understanding that a per barrel tax credit means less tax is paid.

MS. GLOVER restated that the per barrel tax credit is a deduction in the tax calculation.

5:22:55 PM
SENATOR MICCICHE clarified that the oil and gas industry is not paying less tax. Instead, the legislation increased the base rate from 25 percent to 35 percent and added a $5 per barrel credit. This created a progressivity curve because $5 has a greater effect at a lower price than at a higher price. It was designed as an overall process and not as a credit. The idea of it being a credit is misunderstood. The sliding scale changed the curve, but the industry is not paying less tax. The original bill was a lower tax rate. It was increased to 35 percent, so there could be progressivity in the rate.

5:24:08 PM
MS. GLOVER stated that is correct; Senate Bill 21 [28th Legislature] had a 25 percent tax rate with a flat $5 per barrel credit. It then changed to a 35 percent rate with a sliding scale credit for progressivity, so there is a lower tax rate at lower prices. Once the tax credits expire at $150 per barrel, the tax rate is 35 percent.

CHAIR REVAK clarified that the state is not paying out money to the industry.

SENATOR MICCICHE said he had a small correction for the record. The original amount in Senate Bill 21 was 25 percent with no credit. The increase to 35 percent was for the progressivity that was delivered with the $5 per barrel credit.

5:25:44 PM
MS. GLOVER moved to slide 13 and stated the production tax is complicated to discuss in depth. However, the gross value at the point of production (GVPP) is pertinent to SB 3002. The diagram is a simplified calculation of the North Slope oil and gas production tax and can be used to understand the context of gross value at the point of production, net tax, minimum tax floor, and per barrel credits.

5:28:01 PM
SENATOR MICCICHE stated the sectional analysis for SB 3002 appears to have an error. In slide 13, the per barrel credit is not applied to the GVPP. It is applied after determining which is higher net tax or floor minimum.

MS. GLOVER replied, correct.

5:28:49 PM
MS. GLOVER read slide 14:

Per Taxable Barrel Credit

- Component to overall fiscal regime
- Works as an "offset" not as "credit".
- Reduction from Production Tax calculation
- Creates progressivity in the tax calculation up to maximum of 35% production tax as oil prices increase.
- Amount of credit based on the gross value at the point of production (GVPP).

MS. GLOVER stated that when Senate Bill 21 passed, prices were above $100 per barrel. Following its passage, oil prices dropped, which has impacted revenue since credits start at $80 per barrel.

MS. GLOVER explained that the chart on slide 15 shows the current sliding scale changes in $10 increments. The scale starts at a GVPP of $80 and a tax credit rate of $8. The tax credit rate goes down $1 for every $10 increase in the GVPP until it decreases to $0 and the GVPP has reached $150.

MS. GLOVER noted that these numbers are based on the gross value at the point of production price (GVPP) per barrel and not the Alaska North Slope (ANS) oil price, which is the market price. The GVPP is calculated by deducting transportation costs from the ANS price. The cost of transportation averages $9 to $10 per barrel.

5:31:15 PM
MS. GLOVER said slide 16 shows the historic amount of per barrel credits used against a tax liability by all oil and gas taxpayers. The .024(i) and .024(j) tax credits are reported

together for confidentiality. The information is reported in the Department of Revenue's Fall and Spring forecasts and the Department of Revenue's biennial indirect expenditure report. If tax credits were repealed, she said that additional revenue would not equal the amount given in state credits because other credits and deductions could offset the taxpayer's liability.

MS. GLOVER concluded the presentation and asked if there were any questions.

5:32:55 PM
At ease

5:33:21 PM
CHAIR REVAK reconvened the meeting.

5:33:47 PM
JHONNY MEZA, Commercial Section Manager, Division of Oil and Gas, Department of Natural Resources, Anchorage, Alaska, stated that DNR's presentation summarizes the effects SB 3002 has on Alaska's oil and gas revenues.

MR. MEZA said that slide 2 describes the revenues the state receives as the resource owner. He stated that the greatest revenue source for Alaska comes from North Slope and Cook Inlet oil and gas royalties. Early this year, combined royalties were about $30 billion while revenue from net profit-sharing was $1.2 billion, and another $2.3 billion was received from cash bonus payments. Rental payment revenue was $379 million.

MR. MEZA stated that royalties are Alaska's gross oil and gas production shares. They can be received at the n value (dollars) or in-kind (physical hydrocarbons) at the state's discretion. The typical royalty rate for Alaska's oil and gas leases is 12.5 percent. Although there are cases where the royalty is 1/6 or 1/5 of gross production. The royalty owed is triggered upon severance from a lease.

In general, production costs are not considered in the monetary value of royalties. However, transportation costs and quality adjustments are considered. Therefore, royalty is assessed on a gross basis because the royalty calculation does not consider production costs. This is different from the production tax calculation, which considers lease expenditures and is net-based. The changes in Section 6 will not directly impact royalty revenues since tax credits are not part of the calculation of royalties.

5:36:35 PM
MR. MEZA turned to slide 4 and explained that net profit share leases (NPSLs) contain another source of revenue. Companies with these leases share the net profits generated from oil and gas production and have a royalty. The share percentage ranges from 30 to 79 percent.

In contrast to royalties where the state obtains revenue from each barrel of oil and cubic foot of gas produced, revenue from net profit sharing is paid with interest after the development costs of a lease have been recovered. Revenue is generated from the lease after operating expenses are deducted.

Royalty payments are made monthly during times of production. Net profit share payment occurs after the lessee has recovered development costs, which may take years. Therefore, there is a timing difference between the two types of revenue.

5:38:06 PM
MR. MEZA stated that "In the calculation of net profits being shared with the state, the regulations on NPSLs determine an allowance for the potential contribution of the production from the lease to the overall production tax assessed on the lessee (the producer)."

When calculating net profits from a lease, the production tax lease allowance is a deduction to the revenues from the net profit shared lease.

Tax credits, generated by taxable production from the lease, are considered in calculating the production tax lease allowance. Therefore, the proposed changes in the .024(j) tax credits can directly impact revenues from net profit sharing.

5:39:12 PM
MR. MEZA stated that the bonus bid statutes require oil and gas leases to be offered competitively through a bidding variable, which is typically a cash bonus. The bidder offering the highest upfront cash bonus is awarded the lease, including a royalty provision, lease duration, and rental fee. Section 6 does not have an impact on revenue from bonus bids. Likewise, Section 6 does not impact annual rental lease payments, which are about $10 per acre.

5:40:38 PM

SENATOR KIEHL asked what the impact would be on NPSL payments to the state.

MR. MEZA answered that the impact on NPSL payments is presented in the next slide.

SENATOR STEVENS asked if other oil-producing states have the same level of complexity or if there are simpler ways to tax the industry.

MR. MEZA offered his belief that the federal government has utilized NPSLs for federal leases, but Alaska is the only state that has used NPSLs.

5:41:47 PM
MR. MEZA turned to slide 3 and addressed the impact the .024(j) credit might have on revenue from NPSLs. He said the reduction in the dollar per barrel tax credit proposed in SB 3002 was wrongly estimated. The dollar per barrel tax credit is estimated to generate $500,000 in revenue from the NPSLs in the North Slope.

There are 26 NPSLs in the North Slope. Just 12 have recovered their development costs and shared their net profits with the state. So, the reduction in net profit share revenues applies only to a subset of Alaska's NPSLs.

In contrast, the North Slope has 461 leases that contribute revenue through the production tax. So, the impact of .024(j), while significant at the NPSL level, has less significance when viewed as overall production.

5:44:03 PM
MR. MEZA stated that the production tax lease allowance is a deduction to the revenues generated by the NPSL. Therefore, a higher production tax lease allowance means lower profit shared with the state. In this calculation, DNR considers the contribution of the taxable production from the NPSL to the oil and gas production tax credits, like the .024(j) tax credit.

As a result, if there is a lower tax credit, as proposed in SB 3002, then the allowance for the production tax of the NPSL would be higher. This results in lower profit being shared with the state and is how the estimated impact reduction of $500,000 in net profit share revenues was derived.

MR. MEZA stated that his negative impact only occurs when the NPSL has recovered its development costs. He reiterated that only 12 of the 26 NPSLs have recovered development costs. Also, tax credits above the minimum tax have significance because that is the application threshold for the tax credit when calculating the production tax for a lease.

Another effect of the .024(j) tax credit reduction on net profit sharing is a delayed recovery date for development costs. When the lease is not ready to share profits, revenues in excess of operating costs become smaller.

5:46:24 PM
SENATOR KIEHL asked if corporate income tax plays a role in the calculation or if it only pertains to the production tax.

MR. MEZA replied that corporate income tax does not affect the calculation of net profit sharing in these leases.

SENATOR MICCICHE commented that the example is interesting, but the amount is miniscule in the grand scheme of oil tax rates and revenue.

MR. MEZA replied yes; the estimate of $500,000 per year comes from 12 out of 26 NPSLs, while 461 leases contribute to the production tax. This gives a comparison for the impact versus proposed additional revenue from production tax.

5:47:57 PM
SENATOR MICCICHE stated he found the presentation interesting and expressed appreciation that he put the issue in perspective.

5:48:12 PM
MR. MEZA proceeded to slide 4 and provided a simplified example of how the proposed change in Section 6, relating to tax credits, could reduce the shared amount of a NPSL.

The table on the left provides an example of a NPSL producing 1000 barrels per day, having a royalty rate of 1/6, and sharing 40 percent of the net profits once development costs are recovered. Under these terms, the field value of a barrel of oil would be $55 assuming development costs were recovered, the oil price was $65 per barrel, and transportation costs were $10 per barrel.

Since royalty and net profit share payments are assessed each month, the monthly production value of 30,000 barrels would be considered. The production net for the lessee would be 25,000 barrels. Therefore, the gross revenue to the lessee would be $1,375,000 for the month.

5:49:56 PM
MR. MEZA explained that the table on the upper right provides a lower production tax scenario for this hypothetical lease.

Net profit is obtained by deducting operating costs and the production tax allowance from the lessee's calculated revenue. The net profit would be $525,000, and 40 percent or $210,000 would be shared with the state.

The lower left table shows the effect that the .024(j) tax credit would have on this lease when the allowance for production tax associated with the lease increases. If the production tax were to increase from $100,000 to $200,000, the reduction in net profit would drop from $525,000 to $425,000. The state's net profit share would be $170,000.

MR. MEZA reiterated that the example is only for demonstration purposes and is not based on NPSLs in the North Slope.

SENATOR MICCICHE opined that while this example was for illustrative purposes, it is unlikely that a production tax would double in a per barrel credit reduction scenario.

MR. MEZA replied, correct; it was only an arithmetic exercise.

5:53:14 PM
CHAIR REVAK asked how the Department of Natural Resources (DOR) foresees SB 3002 affecting production.

MR. MEZA answered that there is another presentation that addresses the impact of direct and indirect long-term production. He said a high production tax burden might impact the long-term profitability of specific fields. That exercise has not been done, but it could be possible.

5:54:09 PM
CHAIR REVAK recalled an earlier presentation on the net profit share lease bill and asked if the premise was that NPSL production is being thwarted because the state's stake is too high, making production uneconomical.

5:54:54 PM

MR. MEZA replied that is correct. The bill aimed to help fields in marginal situations by adjusting the state's net profit share rate so that production could potentially be economical.

CHAIR REVAK asked if DNR's perspective is that increasing taxes could have a negative long-term effect on production.

MR. MEZA replied that it could reasonably be argued that an additional burden on the production tax could have an indirect impact over the long term and potentially affect the marginal situation of some fields. However, concerning the proposed credit changes in SB 3002, there is a price range where it makes a difference depending on whether a company is above the minimum tax value.

CHAIR REVAK asked what that price range is.

MR. MEZA deferred to DOR for an official estimate but said the amount would vary depending on cost assumptions.

5:57:23 PM
SENATOR MICCICHE stated he understands the value of the net profit share program and that these wells are marginal. He asked if NPSLs should be exempt from changes that might compromise the feasibility of production if the tax regime were changed.

MR. MEZA replied that the regulations on NPSLs refer to a deduction in the existing structure of the production tax system. Therefore, whatever changes occur to production tax in statute will likely be reflected in the accounting of the revenues from NPSLs.

CHAIR REVAK asked if the following estimated annual revenue figures were correct: Per barrel tax $110 million, corporate income tax $67 million, and motor fuels tax $18 million. He also asked what SB 3002 would produce in aggregate revenue for the state.

5:59:19 PM
MS. GLOVER stated that DOR estimated that FY 2022 revenue from SB 3002 would be $79 million. The bill sponsor provided an estimate of $391 million for FY 2025. She offered her belief that the estimate from the bill sponsor came from a presentation by DOR to the Comprehensive Fiscal Plan Working Group. She stated if this is correct, then the numbers presented will be different than the impact of SB 3002.

MS. GLOVER said regarding expanding pass-through entities, there were proposed options with effective dates of January 2021 in the corporate income tax component of SB 3002. The FY 2022 revenue impact assumed retroactivity, which is why that component was larger than the actual impact.

What DOR provided to the FWG expands to other entities. The pass-through only applied to oil and gas entities and did not have the $4 million threshold. So, there are differences between SB 3002 and the bill sponsor's information.

6:01:33 PM
CHAIR REVAK asked when a fiscal note would be forthcoming.

MS. GLOVER replied the fiscal note was submitted and should arrive momentarily.

SENATOR MICCICHE asked if the fiscal note is updated based on the expected Fall forecast or the Spring forecast, which was lower than expected.

MS. GLOVER replied the fiscal note is based on the Spring forecast. Another significant number difference between the fiscal note and what was presented from the FWG estimates was a North Slope price projected increase for July. A higher price forecast changes the impacts for the per barrel tax credit and the pass-through corporate income tax.

SENATOR MICCICHE asked her to provide the number of companies affected by the $4 million net income threshold as well as any available revenue estimates.

6:03:46 PM
CHAIR REVAK reiterated the request.

DAN STICKEL, Chief Economist, Tax Division, Department of Revenue (DOR), Juneau, Alaska, stated DOR would follow up with the information. However, DOR does not have information regarding the impact on non-petroleum corporations and the $4 million exemption in SB 3002. In the forthcoming fiscal note, there is no non-petroleum entities revenue estimate. There is a revenue estimate for the oil and gas industries.

SENATOR REVAK stated that any information pertaining to the assumption of 900 entities being affected would be appreciated.

6:05:03 PM

SENATOR KAWASAKI said that on August 10, there was a fiscal options consideration presentation from Governor Dunleavy. The presentation included modifying the sliding scale, requiring oil and gas pass-through entities to pay corporate income tax, and increasing motor fuels tax, excluding aviation. He asked if there was a fiscal note for this presentation.

MS. GLOVER replied that information from that presentation was based on analysis done using the July ANS price increase. She said she would provide the information to the committee.

SENATOR KAWASAKI asked her to also provide information on motor fuels tax, expanding corporate income tax, and the oil and gas pass-through entities. He commented that the numbers vary, and he would like to compare them.

6:06:55 PM
CHAIR REVAK requested DOR send the information to his office for distribution to committee members.

CHAIR REVAK held SB 3002 in committee.

6:07:52 PM
There being no further business to come before the committee, Chair Revak adjourned the Senate Resources Standing Committee meeting at 6:07 p.m.