

HB373

FISCAL NOTE

No. 1

Bill Version: CSHB 373 (CRA)

(H) Publish Date: 1/24/92

STATE OF ALASKA  
1992 LEGISLATIVE SESSION

Revision Date: \_\_\_\_\_  
Title: "...exemption from property taxation for natural resources in place"  
Sponsor: Representative MacLean  
Requestor: \_\_\_\_\_

Department Affected: Community and Regional Affairs  
BRU: Local Government Assistance  
Component: State Assessor

COMPONENT SERIAL NO.

0	6	7	3
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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL						
REVENUE FUND SOURCE:						

FUNDING: (Thousands of Dollars)

GENERAL FUND	0.0	0.0	0.0	0.0	0.0	0.0
FEDERAL FUNDS						
OTHER FUND SOURCE:						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME	0.0	0.0	0.0	0.0	0.0	0.0
PART-TIME						
TEMPORARY						

Estimate of current year impact: \_\_\_\_\_

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Remond Henderson  
Division: Administrative Services Division

Phone: '65-4708  
Date: 1/13/92

Approved by Commissioner: Ed. Miller  
Agency: Department of Community and Regional Affairs

Date: 1-14-92

Distribution (by preparer): Leg. Fin., Legislative Sponsor, Requestor, OMB/DBR, Gov. Legis. Ofc., & Impacted Agency(ies).  
Rev 10/7/91

COMMITTEE COPY

STATE OF ALASKA  
1992 LEGISLATIVE SESSION

BILL NO. HB 373

Revision Date: \_\_\_\_\_ Department Affected: Revenue  
 Title: Exemption from Municipal Property Taxation for Natural Resources BRU: Revenue Operations  
 Component: Oil and Gas Audit Division  
 Sponsor: Representative Maclean  
 Requestor: Representative Jacko COMPONENT SERIAL NO. 

0	1	1	5
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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
REVENUE						
FUND SOURCE:						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER FUND SOURCE:						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Robert L. Doss, Director Phone: 277-5627  
 Division: Oil and Gas Audit Division Date: January 21, 1992  
 Approved by Commissioner: *David...*  
 Agency: Revenue Date: January 21, 1992

# STATE OF ALASKA

DEPT. OF COMMUNITY & REGIONAL AFFAIRS

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

150 THIRD STREET  
JUNEAU, ALASKA 99801-1291  
PHONE: (907) 465-4700

949 E. 36TH AVENUE, SUITE 400  
ANCHORAGE, ALASKA 99508-4302  
PHONE: (907) 563-1073

January 17, 1992

## POSITION PAPER

RE: House Bill 373

SPONSOR: Representative MacLean

### Program Effects of Bill

The passage of this bill would cause all natural resources in place, as defined in the legislation, to become mandatorily exempt from municipal property taxation. The passage of this measure would make the temporary exemption for natural resources in place enacted by HB 159 in 1990 permanent. That exemption expires July 1, 1992.

### Comments

The Department strongly supports the passage of HB 373. This position is the result of our recent study conducted under CH 127, SLA 1990. The full report of that study, along with our conclusions and recommendations, has already been delivered to the Committee. A suggestion for a minor technical amendment is attached to this position paper.

*Ed. Blatchford*  
\_\_\_\_\_  
Edgar Blatchford, Commissioner

Attachment

# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

400 WILLOUGHBY AVENUE  
JUNEAU, ALASKA 99801-1796  
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January 22, 1992

The Honorable Jerry Mackie, Chair  
House Community and Regional Affairs Committee  
P.O. Box V  
Juneau, AK 99811

Dear Representative Mackie:

Subject: HB 366, HB 373, which relate to an exemption from municipal property taxation for natural resources in place.

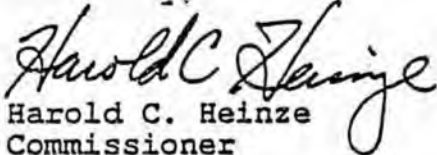
Position: Although these bills do not directly affect the Department of Natural Resources, we offer our support for the taxation policy they establish.

Background: The valuation of natural resources in place is an extremely difficult and costly task to accomplish, and the results are rarely acceptable to all involved parties. Resource development depends as much on markets, timing, and location as it does on the resource itself. Not exempting natural resources in place from municipal property taxation could further discourage natural resource development in Alaska and depress the price the state receives when offering its resources for sale.

In addition, not exempting natural resources in place from property taxation would raise the value of property within municipalities which, in turn, would negatively affect state education foundation aid and revenue sharing monies municipalities are eligible to receive.

Recommendation: Consider the report on taxation of natural resources in place prepared by the Department of Community and Regional Affairs, and adopt its recommendations.

Sincerely,

  
Harold C. Heinze  
Commissioner

cc: Representative Cherie Davis  
Representative Eileen MacLean  
Committee Members  
Paul Fuhs, Legislative Liaison, Office of the Governor  
Edgar Blatchford, Commissioner, Department of Community and Regional Affairs

# MEMORANDUM

State of Alaska

Department of Law

TO: Bob Evans, Legislative Liaison  
Office of the Governor

DATE: April 26, 1988

FILE NO.: 663-88-0410

APR 27 1988

TEL. NO.: 465-3600

SUBJECT:

Exemption of ~~in place~~ natural resources  
MRAD  
DEPT. OF COMMUNITY  
AND REGIONAL AFFAIRS

FROM:

*Marjorie L. Odland*  
Marjorie L. Odland  
Assistant Attorney General  
Governmental Affairs-Juneau

You have requested our opinion regarding a draft bill exempting "in place" natural resources from municipal taxation (Our file: 773-88-0061). You have several concerns regarding the effect and necessity of this bill which will be addressed individually below.

1. What is the state's current obligation regarding the assessment of "in place" natural resources in the full-value determination of a borough or municipality?

The standard by which a local assessor must assess property is set out in AS 29.45.110(a), which reads:

The assessor shall assess property at its full and true value as of January 1 of the assessment year, except as provided in this section, AS 29.45.060 and 29.45.230. The full and true value is the estimated price that the property would bring in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer both conversant with the property and with prevailing general price levels.

Under the above statute, a local assessor must assess all taxable property in accordance with the standard. The determination as to whether "in place" natural resources must be included in the assessment of property and the state's liability for insuring the inclusion of assessment of "in place" natural resources by municipalities is central to your question.

To date, municipalities have not assessed "in place" natural resources. Additionally, the state has not required municipalities to include these resources when determining full and true value of property under AS 29.45.110. There is no case law in Alaska interpreting AS 29.45.110 with respect to assessment requirements of "in place" natural resources nor is there a case

Bob Evans, Legislative Liaison  
Office of the Governor  
663-88-0410

April 26, 1988  
Page #2

in Alaska holding that it is mandatory for these resources to be included in property assessment. However, it is the opinion of this office that "in place" natural resources may correctly be included in the full value determination of a municipality under AS 29.45.110(a) and that the Alaska Supreme Court would support this opinion.

Looking to other states' court opinions and treatise law, it is generally held that the right to tax is purely of statutory creation, and practically all of the authorities are to the effect that assessors, in valuing property, may take into consideration the fact that property contains undeveloped minerals in such quantity as to enhance the value of the land over its mere surface value. See 2 A.L.R. 1550-1553 and cases cited therein. It has also been held that minerals in place are not rendered nontaxable merely because of lack of legislative method and regulation for determining their value. Greene County v. Lattas Creek Coal Co., 100 N.E. 561 (Ind. 1913); 72 Am.Jur.2d State and Local Taxation § 764.

There is case law supporting the view that assessors are required to value for taxation all real property according to its market value. Under those decisions, value is measured by all the circumstances and advantages that tend to enhance it, of which underlying minerals, if accessible, are most important items, so that they must necessarily be included in the valuation. See, e.g., Logan v. Washington County, 29 Pa. 373, 14 Mor. Min. Rep. 108 (Penn. 1857). Any element of value tending to affect selling price "may" be taken into consideration by the assessor in arriving at a proper valuation for assessment purposes. Washington County v. Marquis, 82 Atl. 756 (Penn. 1912). The decisions of the courts in these two cases appear to have been based upon statutes similar in wording to AS 29.45.110(a).

Of main import, is that none of the authorities we found held for the premise that liability attaches to the state or local taxing entity for failure to include "in place" natural resources in their assessments. The authorities we found were based upon cases where a taxpayer was challenging the authority of the taxing jurisdiction to include the value of "in place" natural resources in the assessment of their property.

Furthermore, we found no cases holding that local or state assessors are required to search out "in place" natural resources in order to include them in the assessment of property. The cases mainly hold that it is correct for assessors to take into consideration all "facts" directly affecting the value. It is our opinion that this general rule concerns facts which affect

Bob Evans, Legislative Liaison  
Office of the Governor  
663-88-0410

April 26, 1988  
Page #3

the value of the property that are known or prospective; not sought or speculative.

There is authority supporting the view that assessors may take into consideration prospective value of property as well as present value in making assessments and that an added value may be given property for purposes of taxation where there is "sufficient reason" to believe that the property contains mineral deposits in sufficient quantity to give it a value as a prospective mine. However, there is also authority to the effect that not only must property be valued at its present value at the time of the assessment, but that such value cannot be based on a speculative prospective value. See generally 72 Am.Jur.2d State and Local Taxation, §§ 763-764.

In summary, it is our opinion that AS 29.45.110(a) allows for "in place" natural resources to be assessed and included in the full value determination of a municipality. The issue of whether the state is mandated to assess these resources will be included under the next section dealing with any potential state liability for failure to include assessment of "in place" natural resources in the full value determination of a municipality.

2. If "in place" natural resources are not currently exempted from the full value determination, what liability may the state face if the state assessor does not include these in his assessments?

As pointed out above, the state has never required municipalities to assess "in place" natural resources in order to arrive at the full and true value of property in the municipality. The issue is not whether AS 29.45.110(a) can be interpreted to allow for assessment of "in place" natural resources, since we believe that the Alaska Supreme Court would rule that it does. The issue here centers around the state's longstanding application of this statute in not requiring these resources to be assessed and whether the state faces liability for not including "in place" resources in the assessments. In short, we do not believe that the state faces any present liability for failure to require municipalities to assess "in place" natural resources without a specific exemption in the law.

We are assuming that the liability anticipated by your question concerns a situation where one municipality complains that the state should be requiring another municipality to assess its known "in place" natural resources in the full value determination as it affects the distribution of municipal revenue sharing and education funding. However, a municipality's claim

of deprivation of due process or equal protection against the state must fail. The Alaska Supreme Court recently ruled that a municipality is not a "person" and therefore may not assert due process or equal protection claims against its creator, the state. Kenai Peninsula Borough v. State, \_\_\_ P.2d \_\_\_, Op. No. 3277 (Alaska, Mar. 4, 1988).

If the state changes its application of AS 29.45.110-(a), rules of contemporaneous construction generally hold that a reversal in interpretation of a statute by the administering agency will be applied only prospectively. 2A N. Singer, Sutherland Statutory Construction § 49.05, (4th ed. 1984 rev.) (hereafter "Sutherland"). In other words, if the state reverses its interpretation and administration of AS 29.45.100(a) requiring municipalities to assess "in place" natural resources in their determinations of full value, the state's new interpretation most likely will apply only to future years; not retroactively.

We note that there is caselaw in other states supporting the following viewpoint:

the mere failure of public officers charged with the duty to enforce statutory and constitutional provisions in respect to the levy and collection of taxes, or the acquiescence of public officers in conditions that exempted certain property from taxation, should not be permitted to stand in the way of the "correct" administration of the law, or be construed to estop more diligent and efficient public officers when they attempt to perform their duty by bringing in to the revenue proper subjects of taxation that had theretofore been allowed to escape the payment of taxes.

Sutherland § 49.05 (citing Louisville v. Board of Education, 154 S.W. 379, 380-381 (Ky. 1913)).

Based upon the above viewpoint, we believe that the present state assessor has correctly pointed out that "in place" natural resources may be included in municipal assessments, and **properly should be included**. However, as noted above, it is the opinion of this office that no liability attaches to the state for failure to insist on the assessment of these resources at this time.

3. Is it your opinion that this exemption from municipal resources is necessary?

Bob Evans, Legislative Liaison  
Office of the Governor  
663-88-0410

April 26, 1988  
Page #5

Probably yes, for the main purpose of addressing the issue and clarifying the state's application and interpretation of AS 29.45.110(a). We do not believe any retroactive liability will attach if the state does not immediately provide for this exemption in the law. Additionally, the state may wish to consider whether it wants to make the exemption of "in place" natural resources from municipal taxation mandatory upon the municipalities or whether to allow municipalities the option of providing for the exemption of these resources from taxation.

We hope this addresses your concerns. Please do not hesitate to contact us if you need further assistance on this matter.

MLO/pjg

Resolution of the Alaska Municipal League  
Resolution No. 92-6

A RESOLUTION RECOMMENDING TAX-EXEMPT STATUS OF  
"IN PLACE" RESOURCE RESERVES

WHEREAS, under Chapter 127, SLA 1990, there is a temporary exemption for natural resources in place until July 1, 1992, and

WHEREAS, under the same statute, the Department of Community and Regional Affairs (DCRA), in concert with the Alaska Municipal League and the Department of Revenue, is required to prepare a study and recommendations by January 15, 1992, on municipal property taxation of natural resources in place, and

WHEREAS, the AML President appointed a working group of municipal officials and other individuals which has worked with DCRA to represent the views of municipalities, and

WHEREAS, previously, Alaska law required municipalities that levy a property tax to assess, levy, and collect property taxes on natural resources in place, except oil and gas resources, which are mandatorily exempted, and

WHEREAS, without the exemption, the Office of the State Assessor may be required to include values for those natural resources in place in the full value determination for municipalities across the state, and

WHEREAS, prior to the temporary exemption, neither municipalities nor the Office of the State Assessor included values for those resources on local assessment rolls or in the full value determination, and neither has the staff or fiscal resources to value natural resources in place, and

WHEREAS, the inclusion of values for those resources on local property tax rolls or in the full value determination would be likely to have substantial negative tax impacts on farms, ranches, homesteads, and other residential property and substantial negative impacts on municipalities under the state revenue sharing and education funding formulas, and

WHEREAS, under the Alaska Constitution and existing statutes, municipalities have broad powers to impose a variety of taxes on such industries, including sales, use, severance, excise, property, and income taxes, in order to provide services and mitigate the impacts or development, and

WHEREAS, in the "Draft Report on the Study of Taxation of 'In Place' Natural Resources" dated November 1, 1991, and prepared by DCRA, natural resources in place are defined as *"any material in its native state before it has been severed or extracted"*;

NOW, THEREFORE, BE IT RESOLVED that the Alaska Municipal League supports the passage of legislation that would require, under AS 29.45.030, the exemption from municipal property taxes of all natural resources in place, as defined in the DCRA Draft Report of November 1, 1991, together with language that would insure preservation of the power of municipalities to levy other types of taxes, including severance and sales taxes against the development and sale of those natural resources.

*Adopted at Annual Business Meeting o November 15, 1991 o Fairbanks, Alaska*



# ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 203, Anchorage, Alaska 99503 FAX: (907) 278-7997 Telephone: (907) 276-0347

October 24, 1991

Ms. Sandra J. Wicks  
Deputy Director  
Municipal and Regional Assistance Division  
Department of Community and Regional Affairs  
P.O. Box BH  
Juneau, AK 99811-2110

RECEIVED

OCT 28 1991

MRAD  
DEPT. OF COMMUNITY  
AND REGIONAL AFFAIRS

Re: In Place Taxation of Resources

Dear Ms. Wicks:

It was my pleasure to meet you on Friday at the workshop here in Anchorage. With several mining industry people in the audience I am sure you now realize that we are not the rowdy bunch you had been led to expect.

The purpose of this letter is to relate some of our concerns regarding the taxation of minerals in place. Taxation of minerals in place is detrimental for the mineral industry for many reasons and we urge that the report to the Legislature clearly define these reasons and recommend that the existing statute be changed to exempt in place resources from taxation. That report should also list the many other avenues that are now open to the municipalities for taxation of resource industries.

The first and most compelling reason for not taxing minerals in place is that it is extremely difficult to place a value on minerals before they are actually extracted from the ground. Major mining companies employing scores of exploration, financial, environmental, engineering, and management people have a very difficult time defining the value of a deposit.

These companies have extensive institutional experience with many hundreds of years of combined expertise. They have state of the art equipment, procedures and computers that are used in their evaluation process. They have operating mines, often around the world, for comparison and history as basis for determining mining and processing costs. They work to predict metal market changes and spend many years establishing a management track record and developing markets.

Because of the difficulty encountered in making profits in mining, many companies focus on only one or two metals, or focus only on base metals of copper, lead and zinc. Some companies focus on the precious metals of gold and silver while others search for and mine only platinum or diamonds or coal. Each of these commodities has a sufficiently different and complex set of exploration, mining, metallurgical, financial, and marketing problems that necessitate specialization in order to produce profits.



## ALASKA MINERS ASSOCIATION, INC.

Given an industry with these characteristics and boards of directors intimately concerned with the profitability of each operation, the question becomes: How can local or state tax assessors or their staffs even begin to determine the value of a mineral deposit when these companies have such difficulties determining the value?

The second major problem with the taxation of minerals in place is that it discourages exploration in two ways. First, it discourages exploration in any jurisdiction that utilizes a scheme of in place minerals taxation, and second, it discourages exploration even if in place taxation is on the books but not being used. It will discourage exploration of areas where little is currently known (grass roots exploration) and it will discourage a company from fully evaluating deposits that are already well defined or are already in production. In this instance the tax would discourage the most efficient management of the mine.

Mining companies and financial institutions that loan to them typically have a checklist of items that they consider at each step in their search for new mines. Before a company begins more than a cursory review of mineral prospects in Alaska, they will compare Alaska to the other states, provinces and countries where they may wish to invest their exploration dollars. The items on the checklist will include - regulations, regulatory stability, types of taxes, existing tax levels, tax stability, fiscal stability of the state or country that may affect taxes, etc. The checklist will also address political stability, labor force availability, labor force attitudes, and operating cost considerations.

These items are reviewed before approval is given to spend money in a particular state or country. The exploration business is one of finding likely exploration targets and developing sufficient information to determine if that target can ever become a mine. This process requires many years. For Greens Creek, the largest silver mine in North America, it took 17 years from the initial discovery until first production. For Red Dog, the largest zinc deposit in the world, it took 21 years from initial discovery until first production. For Diamond-Chuitna Coal Co., it has thus far taken 14 years and the first ton of coal has yet to be mined and sold.

If an in place tax had been charged on these minerals before they were mined, there is a high likelihood that no mining would ever have taken place. The cost burden in the early years of a project and the uncertainty as to how long this ongoing cost burden would continue before the mine could start would have been a significant argument against continuing exploration.



## ALASKA MINERS ASSOCIATION, INC.

Each year a mining company re-evaluates the various projects around the world where it can invest its exploration dollars. Within overall corporate objectives, each prospect/project will compete with every other project for funding for the next year. Each year the checklist comes out and further investment is weighed against the results of this year's exploration findings and any changes to the regulatory, tax, political, etc climates. A project in Alaska will have to compete for funding with prospects in Mexico, Bolivia, Indonesia, USSR, etc. If the Alaskan project carries with it a tax on in place minerals, that project will be at a disadvantage.

Because of the lack of transportation infrastructure in Alaska, it is simply more expensive to conduct minerals exploration and develop and operate a mine here than in many other places of the world. In place taxation, and the scary prospect of being taxed on a resource before it is economic, is just one more disincentive to doing business in Alaska.

Alaska is already at a severe disadvantage for a variety of reasons. These include the cost of operating in the north and the lack of infrastructure. They also include the fact that most mining companies have, at least up until the past two years, seen Alaska as a bad place to do business. They have seen Alaska as a place where they will be harassed by all manner of preservationist groups that have claimed Alaska as their big park. They have watched as the state has milked the oil industry at every turn. They have watched some past state administrations thumb their nose at mining and even target mining companies for harassment.

Because of these and many other factors, there are now only five mines in the entire state with more than 100 employees. From World War II until 1989 when Greens Creek and Red Dog began operation there had been effectively no hard rock mining in the State of Alaska. There are 3000 coal mines in the U.S. and in spite of the fact that Alaska has as much coal as the other states combined, there is only one operating coal mine in Alaska. We are, however, now seeing many companies return to look for minerals in Alaska. It is as if Greens Creek and Red Dog have shown the world that it is possible to start a major mine in Alaska. This notion had been in question for many years. Taxation of minerals in place will act to negate the positive changes that have occurred.

A third fact to consider is that taxation of minerals in place is an additional burden on local communities that are already struggling to encourage creation of new jobs and expand their real property tax base. For much of Alaska the only opportunity for economic development and creation of new jobs is through development of the mineral resources. Many parts of the state do not have timber or fish or oil. The only opportunity in those areas for good-paying, skilled, close-to-home, year-around jobs is the development of the minerals. It should also be noted that on a nation-wide average, mining jobs are higher paying than comparable jobs in other industries.



## ALASKA MINERS ASSOCIATION, INC.

If in place minerals are taxed, local communities will be hurt without even knowing it. Many of the mining companies that have the expertise to find and develop the minerals will not even go out in Alaska to look for new mines. They will not be there to provide exploration jobs in the early years of a project nor will they be there to provide mine operating jobs and long term employment.

During the meeting here in Anchorage, State Assessor Mr. Mike Worley described the assessment of value as a combination of many factors. He described this as the value of the facilities and improvements along with the value of a particular piece of land based on its location or setting. The value of an undeveloped lot therefore includes the potential value of the lot for the highest and best use to which it could be placed. A fourth major problem with in place taxation is therefore: How will the value of the non-tangible natural resources that exist due to location or setting be determined? For the lot in town, this non-tangible value is determined and it will have to be determined for all areas of the state.

For example, how will "wilderness character" be valued? This is clearly a natural resource that is in place and it too will have to be taxed. What is the value of "wilderness character" for a remote area where one can see wildlife on a consistent basis? What is the increased value of a parcel of land that has a fabulous view of Mt. McKinley or Mt. Saint Elias? Those sites have a natural resource value based on their location just as the lot in town has a value based on its location.

This is an "opportunity value" that exists for many different resources. A tremendous opportunity may exist if a lodge were to be constructed and marketed for European or Japanese customers at \$5000 per week. Until that lodge is built and has developed its niche in the market it will be impossible to determine what that opportunity value really is. It will be easier to calculate for lodges and resorts that are already in operation and are benefitting from the opportunity value of the natural resources around them.

Mr. Worley also discussed several tax policy considerations. These included fairness between taxpayers and fairness between municipalities. If natural resources are to be taxed in place and taxation is to be fair, all areas of the state will be subject to taxation of their scenic values, wilderness character, wilderness proximity, and other such resource values.



## ALASKA MINERS ASSOCIATION, INC.

What about hunting and fishing lodges? What about lodges that focus on hiking or mountain climbing? These often occupy and utilize the most beautiful parts of the state. They will be subject to taxation of the resources they utilize even if the resources are not consumed, just as in the case of minerals that are not extracted from the ground. Of course it could be argued that the hunting and fishing lodges do indeed consume some of the resources.

In a similar vein, a fifth problem with taxation of natural resources in place involves how will the fish resources available to fishing sites be taxed? The fish are clearly a natural resource. The "lot" where the fish site is located has a measurable market value but it also has an "opportunity value" by virtue of the fish that pass the site. If the fisherman is diligent and fishes every minute of every opening he will likely have a greater profit than if he fishes only the best or most convenient openings. What then is the basis for taxing the in place resource that is available to him?

A sixth problem is whether or not it would be cost effective to attempt taxation of in place resources. The above examples show some of the difficulties that will be encountered. What will be the cost of assessing the in place resource values for fish, timber, wilderness character, scenic views, lodges, and minerals? The direct financial costs to the municipalities and the state will be very high as will the indirect costs that will result.

The direct costs are not a one time charge either. Value assessment of in place resources will in many instances require a yearly re-evaluation. Fish resources available to the fisherman will vary from year to year as will the cost of operation and the price that he can get for the resource. From a minerals standpoint the "value" of ore deposits also change each year. Some ore is mined (hopefully), additional drilling may add to the ore reserves, changes in the metallurgy of the ore being mined (the difficulty of removing the metal from the rock) may increase costs, other factors may increase costs, and the prices received for the metals will always fluctuate. Each of these changes means that the "value" of the minerals in place will change.

The issue of annual re-evaluation should be a concern. I believe Arizona is one of only two states that still attempts to tax ore reserves in place. I talked with mining industry officials there and learned that in Arizona there are five major mining companies that have 14 operating properties with copper and gold being the primary commodities produced. The assessed value of the ore reserves are re-evaluated each year based on metal prices, operating costs and profits and the process is a very strenuous one for all concerned.



## ALASKA MINERS ASSOCIATION, INC.

The indirect costs will include disagreements between the lodges, fishermen, loggers, miners, etc. seeking to operate, and the municipalities. Arguments and discontent between these groups and the municipalities would become a very divisive factor for the communities. We need only look at the problems that arise right now when assessors seek to place a value on real property that can be seen, touched and measured. Therefore, what will it be like to value resources that cannot be seen, touched or measured?

A seventh problem will arise when a company that has been taxed for several years on the in place natural resources decides that the project is not economic and asks for reimbursement of the taxes that had been paid. This could be a lodge developer that sees his potential market change or it could be a mining company that concludes that the metallurgy of the ore is too complex and costly for a mine to be profitable.

The above points show the extreme difficulty of in place taxation of resources. For some resources the valuation process (assessing) is more difficult than for other resources. Considering minerals, it is nearly impossible for these to be valued for taxation and if they are taxed the ultimate effect will be less exploration in Alaska and there will be fewer jobs generated.

In considering taxation of in place resources, all of these resources will have to be valued and taxed. This would be a herculean task. We therefore urge you to provide the State Legislature a recommendation that the statute be changed to exempt all resources in place from taxation.

Sincerely,

Steven C. Borell, P.E.  
Executive Director

# **Municipal "in place" resource tax issue will be back before lawmakers in 1992**

**A Special Analysis  
by  
Tim Bradner**

## **Valuation of resources could impact many things ?**

Municipal taxation of resources "in-place" will be before the Alaska legislature again in 1992 — a two-year exemption enacted by 1990 will expire next July. If the legislature does not extend the exemption, municipalities will face the question of whether they should impose these kinds of taxes. Because of the way local assessments affect formulas for state school revenue-sharing, the issue directly affects the amount of money local school districts get from the state.

State lawmakers may establish a framework for assessments, or impose limitations, on the way local governments impose resource taxes. The State Dept. of Community and Regional Affairs has a study of the issue now underway, which will include the experiences other states have had with natural resources property taxes.

## **State law appears to require valuation of resources in place**

Resource "in place" taxes are property taxes placed on the value of raw, undeveloped natural resources. Alaska statutes exempt certain kinds of property — oil and gas — from in-place taxes, although surface facilities related to oil and gas are subject to tax. But the law is silent as to other types of resources, such as minerals or timber.

The issue mainly affects mining developers most directly because several major projects — the AJ Mine eventually Greens Creek Mine in Juneau, Red Dog Mine in northwest Alaska, the Usibelli and Wishbone Hill coal mines, Fort Knox in Fairbanks — are within municipal boundaries. The companies developing these projects are concerned over uncertainties that arise from different theories of municipal appraisals on undeveloped mineral properties. Some of these projects are economically marginal, and new local government taxes would affect the economic viability of the projects. Sand and gravel owners and operators should also be concerned. Timber properties would also be affected, but trees are easier to appraise simply because they can be seen, counted and graded. They are more "quantifiable."

## **How the issue complicates state school revenue-sharing**

The complication with state school funding arises because the state assessor is required to prepare a statement of the full and true real and personal property in the state (AS 14.17.140), and must yearly do a full value determination for each municipality. The full value determination is a basic element of the formulas for school funding and state revenue sharing. If statutes do not specifically exempt resources in place from local taxation, the implication is that they should be subject to local taxation, and thus a part of the "full value" determination. *(Cont'd page 4)*

*(Continued from page 3)* But if the value of resources, having been determined, is added to the basic assessment of municipalities, the result will be changes in the amount of education revenue sharing. For the Northwest Arctic Borough, which includes the Red Dog Mine, this could have dramatic financial consequences, for example.

## **Implied taxability of resources has always existed in state law**

The implied taxability of undeveloped resources has always existed in Alaska law, but in practice most municipalities did not attempt such taxes because they felt the values would be hard to determine and, if undeveloped, had little or no value. Where they were taxed, market-value appraisal techniques were applied. In Fairbanks North Star Borough, for example, the value of surface lands on some mining claims have been taxed.

But major mining projects within municipalities do have undeveloped ore reserves of some value. Determining that value is a major issue. If state law appears to require "full value" assessments, the value of those ore bodies should be included in local tax bases. The problem faced by municipalities is that even if they choose not to impose property taxes on resources, the state assessor may be required to include them in his or her own determination of municipal assessed value, in which case the municipality loses state education funds.

Local governments may also be subject to citizen lawsuits by failing to tax in-place resources. Alternatively, the state assessor may be under legal challenge by other municipalities without natural resources who would argue they are losing state education money because other local governments with resources are not being appraised fairly, under state law.

## **How to define "resources in place"**

One problem is how to clearly define the term. The phrase "in place resources" does not correspond to any commonly used assessment terminology, and appears to be very broad. Chapter 127, SLA 1990 (which imposed the temporary two-year moratorium on taxation) refers only to natural resources in place as, "including proven or unproven mineral and other deposits of valuable materials and timber stumpage...".

What is ambiguous in that definition is the phrase "other deposits of valuable materials." This very likely includes sand and gravel, but would it, for example, also include glacier ice, if it had some form of economic value? The Dept. of Community and Regional Affairs, for the purpose of its own study, uses the definition "Any material in its native state before it has been severed or extracted."

*(Continued next page)*

**This article on "in place" resource taxation first appeared in our special Digest supplement publication for special small communities, municipalities, and schools published in late November (No. 21/91).**

## **The CRA study is 'evolving'**

*(Continued from page 4)* As the C&RA study is now evolving, two discreet positions are developing, not only over the question of whether such taxes should be imposed, but over the definition. Some state agencies, and appraisal experts retained by them, feel the definition of mining properties should be linked to the term "proven reserves" because that phrase has well-established meaning in the mining industry (it means ore reserves definitely established by drilling, as compared to more general estimates). Municipal appraisers, on the other hand, want a very broad interpretation. For them, "resources in place" should be defined as "any material in its native state without regard to quantity, quality or economic value." Appraisers want the term defined broadly so others will not misinterpret it in a limiting way.

### **Two positions that have formed up over the definition are these:**

(1) Natural resources should not be subject to municipal tax before they are severed because it is technically infeasible or impractical, and because taxation of an ore body before development takes place will hamper development of the resource. The State Departments of Commerce and Economic Development, Natural Resources, Revenue and the Office of the State Assessor (CRA) hold this position.

### **A contrary view is:**

(2) Taxation of resources in place before extraction takes place should be available to municipalities if the resource has a measurable value that can be demonstrated by accepted appraisal practices. Alaska Municipal League and Alaska Assoc. of Assessing Officers takes this position.

## **What some municipalities now do**

Several municipalities tax resources in various ways, but always at the point of extraction or in a manner where values are clearly demonstrated. In Ketchikan Gateway Borough, City and Borough of Sitka and Kodiak Island Borough, timber is a resource but most of it is owned by Alaska Native corporations exempt from taxation under federal law, and from local property taxation until development occurs. In other jurisdictions, such as Haines and Juneau, municipal assessors have not valued timber separately from surface estate.

Other marketable timber in Southeast Alaska is outside local government areas. Until 1986 mining claims were assessed at a flat \$200 for every 20 acres. After 1986, mining claims were to be valued at their full and true value, but in practice, values were based on the value of surface holdings, with no regard to subsurface resources.

Four boroughs that encompass large areas, including mineralized regions, do not have property taxes: Northwest Arctic, Aleutians East, Lake & Peninsula and Denali. However, Kodiak and the Denali Borough have resource excise taxes that tax as the resource as extracted. Kodiak's tax applies mainly to fish and timber, but it broad enough to apply to minerals as well. Denali Borough has a specific resource extraction tax levied on coal — \$.05 cents per ton of production, and gravel, \$.05 cents per cubic yard of production.

*(Continued page 8)*

## **Problems of assessing natural resources**

(Cont'd from page 5) One problem municipalities face in imposing taxes on resources in place is administrative cost. Appraisals require expertise in several professional fields, and the going rate for these kind of services is \$150/hour. If several natural resources in a municipality were to be appraised, it would be extremely expensive. An alternative would be for the state to perform a uniform appraisal, similar to the process now used for oil and gas properties subject to the state oil and gas property tax. Both municipalities and the state levy property taxes on petroleum facilities (the local tax is credited against the state tax by the taxpayer) but the valuation is done by the state.

If resource-in-place taxes were to be allowed, private industry might prefer this approach because it would avoid a patchwork of different appraisal methods used across the state. Uniformity in the state assessor's full value determination, for school revenue sharing, might also require it. More serious is the problem of actual establishing value.

Robert Paschall, a consultant retained by both the state and the Northwest Arctic Borough to do assessments of the Red Dog Mine, noted that metallurgical problems being experienced by Cominco Alaska, the operator, would result in the value of the ore body dropping from \$100 million to \$30 million. In two to three years, when those problems are solved, the value would increase again to \$100 million. Dramatic swings which are typical in world metals prices will also affect the in-place value of ore reserves. Obviously, such fluctuations in assessed value would make property tax collections very unpredictable, and add uncertainty to annual state school revenue-sharing.

### **Northwest Arctic example portrays the 'uncertainties'**

An illustration of how this would affect the Northwest Arctic Borough: If the approximate state Full Value Determination for Northwest Arctic Borough is \$446,850,000, the addition of \$100 million to its tax base would increase its Full Value Determination by 22 percent, resulting in a decrease of \$400,000 in annual school funding. Against this uncertainty, timber presents a different issue. Timber is easier to value because it can be seen and measured, although market prices can also be volatile, and in-place value is also affected by its location (more remote, difficult to access stands would have higher costs, thus lower in-place values).

### **What other states do**

Thirty one states can legally tax natural resources in place but only 12 states actually do it, in varying ways. Arizona, Colorado, Indiana, Kentucky, Michigan, Mississippi, Missouri, South Dakota, Texas, Virginia, West Virginia and Wisconsin now have different forms of resource in-place taxes. Nineteen states exempt natural resources in place from property assessments.

States that do have active resource in-place taxes have resources sufficient to generate the revenue to justify staff and expenditure. Arizona and Kentucky are very active, but both centralize the assessment function with state government, to assure uniformity. Kentucky assessed and taxes at the state level, then passes the revenues through the local governments. Arizona provides assessments to local governments, which then levy the tax.

*(Continued next page 9)*

## **Sales approach to value hard to "verify"**

*(Cont'd from page 8)* In other states that allow in-place taxes, many rely on the market, or sales approach to valuation, a traditional method in real estates appraisal. But actual sales of resource properties are rare, hard to verify, and are often not comparable to other properties being assessed. Many states have mandatory sales disclosure laws, which requires sale prices to be provided to assessment offices. Still, sales data is considered generally inadequate to reliably assess resource properties. Generally, many states that allow in-place taxes disregard them because of lack of reliable data. In Canada, resource taxation is generally similar to that of the U.S. Resource development projects are subject to federal, provincial and local taxes in the form of income and severance taxes.

## **A complex impact on projects**

The Department of Commerce and Economic Development pointed out that states with the highest taxes, including in-place taxes, offer more in the way of infrastructure for industrial development than does Alaska. Alaska mining operators now pay a mining license tax, state corporate income taxes, and rents and royalties, such that the total burden on mining places Alaska in the upper 1/3 of states with taxes on mining. The department also said: "A tax on unmined, in-place reserves would seriously penalize a company for pursuing the sensible, longer-term, in-depth approach to evaluation of an ore body. Companies now often take a slow methodical approach to proving up properties. A tax might discourage programs to define reserves. Instead such a tax might encourage a company to make a quicker, less-informed decision that could result in costly mistakes or, just as bad, the abandonment of a good project that simply needed more work to demonstrate its economic viability." DCED also questioned whether a tax on standing timber would encourage premature harvesting of the resource to avoid taxes, or otherwise distort harvest planning based on market criteria.

## **Comments from state agencies included in the C&RA study**

The State Assessor pointed out that, based on the Red Dog experience, the complexity of valuing ore bodies is beyond the experience of local governments and state agencies in Alaska. Alaska Municipal League contested this assertion, and said that Alaska assessors are capable of valuing resources if market criteria can be developed. If minerals are to be taxed, the state assessor said, "proven reserves" should be the criteria and the assessment function should be centralized in state government. Municipal League also opposed this: "Only the state perceives a problem with current assessment practices. Municipalities do not want the state to determine local values or increase the regulation of local taxation," AML said in correspondence to the C&RA study team.

The state assessor also said the state does not now have adequate staffing or trained personnel to undertake a central assessment task. Alaska has other problems, the assessor pointed out: Adequate maps and complete property ownership information are not available. Municipal League said: "The question of taxation refers only to known natural resources that have measurable market value. The broad definition of in-place natural resources includes known and unproven deposits of material that may not have any measurable market value. By definition, ad valorem taxation is based on value. No value - no tax.

*(Continued on page 10)*

## **Other thoughts: "Community tax inequities will remain"**

*(Cont'd from page 9)* There are other perspectives in the shadows of debate over taxation of resources "in place." One such issue is the inequities **between "have and "have not" Alaska local governments** . Some have rich tax bases, some have little, some no hopes of a tax base. Naturally, every local government is looking for a high value/per capita industrial tax base. However, Alaska has many local governments with marginal tax bases, and even whole regions denied choice of real local government because they have no hope of a tax base. The resources "in place" tax issue is an initiative by some local governments looking for badly needed tax resources. As a matter of principle they would like to bring their fellow governments along for the philosophical ride. However, as the Alaska map fills up with local governments, these local governments will sooner or later turn to look at each other, and examine the sizable tax inequities between them.

### **Industrial tax base sharing ?**

If inequities become glaring enough there may well be a movement to construct a kind of state law provision that would allow 'have not' local communities to share in the benefits of a defined state industrial tax base. The problem with industrial and resource tax wealth is they tend to center on a few areas. In terms of philosophy, a tax sharing provision would be a cousin to what Congress constructed in the controversial 7(i) feature of federal native land claims legislation, a provision that requires the sharing of a portion of resource revenues between all corporations..

There is already a great disparity of tax wealth between Alaskan communities. For example, the North Slope Borough may well be the richest local tax base in the North America. In 1990 the North Slope Borough was at the top of the Alaska tax value list with a value of \$1.53-million per capita (oil property). At the bottom of tax value cities was Hooper Bay with \$8,943 per capita. Second in value in 1990 was the City of Valdez at \$280,739 per capita (oil transp facilities), followed by other boroughs and cities with some measure of industrial tax value, such as the Kenai Borough with \$86,111 per capita (oil facilities), Bristol Bay Borough, \$92,566 per capita (fish plants), Sitka and Ketchikan (pulp plants) with \$54,349 and \$63,597 per capita. However, the new Aleutians East Borough has only \$32,077, and the Lakes and Peninsula Borough has \$34,447. Municipalities with virtually no industrial base generally fall between \$25,000/\$45,000 per capita. Fairbanks and Anchorage are only in the \$42,000/per capita range, but these two communities are commercial centers that, should need require, have potential access to high yield revenue through a sales tax. A sales tax in St. Mary's, Hooper Bay, Dillingham, or Nome offers no similar high yield.

### **Direct resource tax load and trade "contradictory" ???**

Another perspective --a direct resource tax load and international trade may not mix. Remember taxes must generally be "uniformly applied." One resource may be able to stand a tax load, while another bound into extremely competitive international markets cannot stand a high tax load. A government may not be able to legally differentiate. Some economists suggest that the term "Pacific Rim" trade, with regard to any expectation of very high resource royalty or tax yield, is simply an economic contradiction. The increasingly competitive world trade market suggests that taxes, other than taxes related to management and environmental cost, must come from indirect taxation, from income taxes and sales taxes, not from a front end load on the product.

*One of our year long feature issues ?*

## **Can resources pay tax load, or must people pay taxes too ?**

Throughout 1992 we will examine the ongoing issue of expanding the state's tax base. Alaskans are fond of talking about the need to diversify their economy. Implied in this rhetoric is the suggestion that somehow 'new revenues' associated with this diversification will replace lost oil revenue.

The reality we will discuss throughout the year is whether it is realistic for Alaska to expect that many other resources can really be taxed directly, or pay royalties that provide significant revenue. Some types of resources may only be able to afford to pay for their own management and some social and rehabilitation costs. This discussion will surface intermittently throughout our publication year in Legislative Digest. We do not suggest that other resources should be 'taxless,' but we will explore whether there are other resources that can replace skidding petroleum production revenue earnings. At the bottom of this review is the reality of whether we can add much tax load to natural resources that already carrying high Alaska production costs, and still expect to be competitive in the market --especially international markets. Facing tough international competition, some resources will only be able to pay payroll, but will employ people who will, in turn, pay taxes for public services.

**In this context we will discuss:**

- (1) Where other states get their taxes?
- (2) Keeping state and local taxes separate!
- (3) Problems with direct resource taxation.
- (3) The stake of the business community in insuring that the state over the long-haul adopts a 'fair" agenda of taxes.
- (4) The stake of the citizen and local communities in insuring that Alaska adopts a fair tax agenda, that avoids the kind of tax competition and loading that has occurred in other states!
- (5) Public understanding of direct resource tax load and the ability of high cost Alaska to compete in the international market.