THE STATE
of ALASKA
GOVERNOR BILL WALKER

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The Honorable Paul Seaton
Alaska State Representative
Chair , House Revenue Finance Subcommittee
State Capitol, Room 505
Juneau, AK 99801

Dear Chair Seaton:

The purpose of this letter is to provide you with responses to the questions asked of the Department of Revenue (DOR) during our presentations to the House Finance Revenue Subcommittee on February 3, 2017 and February 10, 2017 regarding Tax Division budgeting items and indirect expenditures. Please see questions in italics and our responses immediately below the questions.

1. *Provide more information concerning additional corporate income tax auditors and potential revenue opportunity.*

   Over the past three fiscal years, on average, each corporate auditor has assessed $8.8 million in audits, while collections from audits has averaged $8.7 million per auditor.

   Specific to non-oil and gas, each corporate auditor has assessed $2 million per year in audits while collections have averaged $2.5 million per year. Note that there are timing differences between assessments and collections.

   If new auditors are funded in the budget, the Tax Division would begin recruitment with a goal of having staff begin work on July 1 or as soon after as possible. The corporate group has a 12 week training plan, and auditors would also do on the job training wherein they would conduct actual audits.

   Previously, we stated that a conservative estimate of additional revenue per new auditor would be $500,000. Given the historical average assessment numbers, we feel confident we could produce $500,000 per new auditor in the first year after hire.

2. *How many breweries were receiving the benefits of the small brewery reduced rate?*

   In FY 2015 there were 61 taxpayers for this tax type. Of those 61 taxpayers, 29 taxpayers received the benefit of the reduced rate because they had some amount of "reduced gallons sold". In FY 2015,

25 in-state brewers received the benefit of the reduced rate and 4 distributors received the reduced rate (distributors sell beer produced both in-state and out-of-state).

3. *How much beer was produced in-state vs. out-of-state (relating to the small brewery reduced rate)?*

   During FY 2014 through FY 2016, approximately 4 million gallons of reduced rate beer was sold in Alaska annually. Analysis of Tax Division data indicates that in FY 2014, 38% of reduced rate beer sold in state was from out-of-state breweries, with 36% from out-of-state in FY 2015 and 35% from out-of-state breweries in FY 2016.

4. *How much of the benefit (revenue impact) goes to in-state vs out-of-state (relating to the small brewery reduced rate)?*

   Preliminary analysis shows that about a third of the revenue impact is attributed to out-of-state beer being distributed by large distributors. As far as revenue impact, dollars foregone by the State of Alaska due to application of the reduced rate amounted to $2.8 million in FY 2015. Approximately $1.8 million was a benefit to Alaskan breweries, while $1 million benefitted out-of-state breweries.

5. *On the cigarette deduction for affixing tax stamps, will they still continue to put the stamp on if we get rid of the deduction (relating to the stamp act within the cigarette tax)?*

   Each pack of cigarettes must be stamped before being distributed. Most distributors do the stamping themselves. Distributors purchase the cigarette stamps from the Tax Division, stamp their cigarettes, and then sell the cigarettes to retailers in the state. They are then able to claim the credit on their tax return for affixing the stamp.

   The statutes require the stamps be affixed prior to distribution or the cigarettes are subject to seizure. A 100% penalty also applies in addition to the seizure. Distributors could also lose their tobacco license if they do not comply with the stamp statute. Since distributors must sell only stamped cigarettes in the state, they would have to continue to stamp or cease selling cigarettes in the state.

6. *What is the current status of long-term capital gains tax rates (relating to the reduced tax rate on capital gains within the corporate income tax)?*

   When the reduced tax rate on capital gains was enacted in Alaska, in 1975, the top federal corporate income tax rate was 48% and the maximum capital gains rate was 30%.

   Currently, the top federal corporate income tax rate is 35% and there is no longer a federal preferential tax rate for corporate capital gains, it is now the same rate as a corporation's ordinary income tax rate.

7. *Have we seen an increase in mining operations and do we have projections due to this benefit (the 3.5-year exemption of mining license tax)?*

Most new mines are not profitable (i.e. do not report taxable income) during their first 3.5 years. Therefore, the 3.5 year exemption does not tend to affect them at all.
There are currently only 3 mining operations that are subject to the 3.5-year exemption (none of them are large mines), and there are no large mines currently projected to open within the next 5 years. None of the current mines with the exemption reported taxable income last year.

8. *Can a company claim an education credit for multiple tax types?*

Yes. A taxpayer could claim the credit against multiple tax types if it had sufficient contributions, but they cannot receive multiple credits for the same contribution. For example, if a taxpayer contributed $300,000 to a qualifying educational institution, they could choose to claim the full $300,000 as a credit on either their corporate income tax return or on their production tax return but not on both. They could also choose to claim part of the contribution on one tax return and part on another as long as it did not duplicate any amount (e.g., $100,000 on their corporate tax return and $200,000 on their production tax return). Likewise, if a company contributed $600,000, they could claim $300,000 on their corporate tax return and $300,000 on their production tax return and benefit from the 100% credit on the two different returns.

9. *Provide more information regarding why the value of oil intangible drilling expenses and exploration expenses are excluded from taxation under the Oil and Gas Property Tax.*

DOR staff looked briefly at the legislative history of AS 43.56, which was enacted in 1974. The historic record is limited, and the issue was only scantly referenced. However, at the time, most of the oil and gas activity and therefore property was in Cook Inlet, in the taxing jurisdiction of the Kenai Peninsula Borough. KPB's practice was to not tax some portion of the drilling costs; it is possible the legislature in 1974 maintained this exclusion out of continuity. It is also possible that the intangible drilling costs were excluded as an incentive for exploration.

The existing "IDE" exclusion's primary impact is to the assessment of wells and the infrastructure necessary for drilling those wells, rather than pipelines or other support infrastructure. With oil and gas property, a reasonable rule of thumb is that about 15% of the cost of a well is tangible and the remaining 85% is intangible.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

Sincerely,

Randall Hoffbeck
Commissioner