



Mining Taxation in Alaska

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Mining Taxation Policy: Finding the Balance

Mineral tax policy should balance a reasonable share for the state with an economic environment that spurs development. This will attract investment and encourage a robust, responsible mining industry. The resulting mineral revenues should provide a net benefit to the state and the prospect of reasonable economic return to the investor. In addition to local and state government revenue, the industry's contribution should also be measured by its economic impact. This includes highly skilled and highly paid jobs, construction and maintenance of valuable infrastructure, procurement and contract opportunities for local businesses, and—unique to Alaska—revenue sharing among Alaska Native Corporations from mining on ANCSA corporation land.

Alaska has world class mineral reserves¹. So it is surprising that despite billions of dollars spent on dozens of exploration projects since the 1980s, we have only five large metal mines. Bringing a project in Alaska from exploration to production is very expensive. Our climate and geographic location drive up the cost of many economic activities in our state. What's more, Alaska has unique infrastructure challenges that result in longer and more costly mine development timelines and operating challenges. If our currently undeveloped deposits were in the Lower 48—closer to roads, rail, and power—they would probably already be operating mines.

Given the high cost of development, it is imperative that our tax policy make Alaska more attractive to investors than other competing jurisdictions. Alaska has several advanced exploration projects. It makes sense for the state to support these projects because getting even one into production will result in a significant increase in mining tax revenue.

Alaska has world class mineral reserves.

Despite this potential Alaska only has 5 large metal mines.

How do we make Alaska more competitive?

Growing Alaska's economy starts with reasonable, predictable regulation and attractive fiscal terms.

¹ If Alaska were a country, it would rank 7th in the world for zinc reserves and 10th for gold reserves. Alaska Division of Geological & Geophysical Surveys, 2018 data.

Alaska's Current Mining Taxation System Works

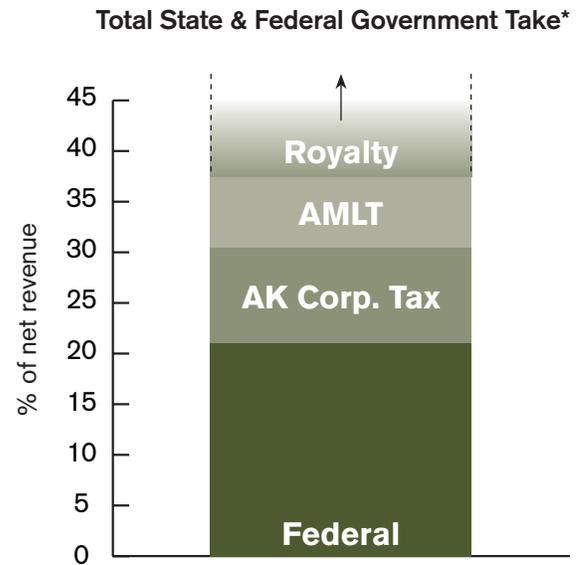
The mining industry is a valuable source of stable revenue for local governments, as well as a significant contributor to the state's general fund. In 2018, mining paid \$183 million in local and state government revenue.

State Revenue from Mining ²	2018 ³
Mining license tax, rents, royalties	58,800,000
State corporate income tax	34,600,000
State material sales, misc. fees	9,500,000
Alaska Railroad Corp ⁴	15,900,000
AIDEA facility user fees	28,200,000
Alaska Mental Health Trust ⁵	1,600,000
Total paid to state	148,600,000
Payments to municipalities	34,200,000
Total paid to local and state	182,800,000

Alaska Mining License Tax (AMLT)

All mines and royalty holders in Alaska, regardless of ownership or location, are subject to the state mining license tax. The large mines (net income greater than \$100,000) pay the highest rate: 7% of net income. In 2018, the state received \$58.8 million in AMLT revenue.

Mining Net Income	AMLT Rate
\$0 - \$40,000	No tax
\$40,001 - \$50,000	\$1,200 + 3% over \$40,000
\$50,001 - \$100,000	\$1,500 + 5% over \$50,000
Over \$100,000	\$4,000 + 7% over \$100,00



² Includes revenue from coal.

³ The Economic Benefits of Alaska's Mining Industry, March 2019, McDowell Group, Inc.

⁴ Revenue from moving coal, sand, and gravel.

⁵ Mining claim and lease rent and royalty payments, and construction material sales

*Most mines also pay local property tax or a PILT

Corporate Taxes

Mining corporations, like all C corporations doing business in Alaska, pay the state's corporate income tax. The top tier, 9.4% of net income, is one of the highest in the country. Out-of-state mining companies investing in Alaska must be authorized to do business in the state and they are subject to the same laws and taxes. In 2018, the Alaska mining industry paid \$34.6 million in state corporate income tax.

Alaska's corporate tax rate is one of the highest in the country.

Rents & Royalties: Revenues for the State & the Alaska Permanent Fund

Revenue payments to the state, other than the mining license and the state corporate income taxes, are determined by the land status of the mine. The state collects rents (based on acreage) and royalties (3% of net income) on mines operating on state lands, and a portion of those royalties are deposited directly into the Alaska Permanent Fund.⁶ Mines located on private lands, such as lands owned by Alaska Native corporations, pay royalties and additional payments to the land owner.

The State of Alaska received millions of acres from the federal government for which the mineral potential was completely unknown. Most claims will never be put into production; without production, there is no royalty for the state. Having a low royalty encourages explorers to risk capital in an attempt to find mineral sources that can be developed, thus adding to the state's economy. The exploration activity itself also has a positive economic impact by employing Alaskans and contracting with Alaska businesses.

The Alaska Mental Health Trust selected lands with known mineral potential — and, in some cases, known prospects — to provide a source of revenue to support its mission. The high quality of the lands selected put the Trust in a strong negotiating position with respect to the royalty to be paid by its mineral lessees.

The Fort Knox mine in Fairbanks operates on Mental Health Trust land in addition to some state land. Several potential metal mines, including the Livengood project outside Fairbanks, are located on Mental Health Trust lands. In 2018, the Alaska Mental Health Trust received \$1.6 million⁷ from mining claim and lease rent and royalty payments as well as construction material sales.

Net Income

A net income calculation for taxation and royalty makes sense for Alaska because it takes into account the high cost of developing and operating a large metal mine in our state.

Operating costs in Alaska are high due to lack of infrastructure, our harsh climate, and transportation challenges. Red Dog, located above the Arctic Circle, illustrates the logistical challenges of seasonal access. A mine must operate year round to be economic, so Red Dog's concentrate is produced and stored for most of the year then shipped to buyers during a 3-4 month ice-free shipping season. Equipment, fuel, and all necessary supplies must also be delivered at this time as the only alternative is exceptionally

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⁶ If the mineral lease was issued before Dec 1, 1979, 25% of the lease rentals, royalties, royalty sale proceeds, mineral revenue sharing payments and bonuses received by the state are deposited in the PF. For mines operating with state leases issued after December 1, 1979, 50% is deposited in the PF.

⁷ The Economic Benefits of Alaska's Mining Industry, March 2019, McDowell Group, Inc.

expensive air delivery. The Donlin Gold project in the Yukon-Kuskokwim region faces the same challenge. The current net income tax structure also yields more revenue to the state when the mine profits are higher.

Alaska’s regulations⁸ are very prescriptive about what can be deducted in determining net income. Deductible expenses from gross revenue include: operating costs (wages, transportation, consumables, equipment, spare parts, power, administration, IT, post production permitting, legal, insurance); cost of supplies; cost of contract services; interest; royalties; capital costs, including interest on capital invested (depreciation and amortization); depletion allowance; and state corporate income tax, local taxes, and fees. Federal income tax, operating losses, and exploration expenses are not deductible⁹.

Many people are surprised to learn that pre-production costs like exploration and permitting are not deductible expenses. To put this in perspective, these pre-production costs for developing a large mine can be hundreds of millions of dollars. Apart from the one-time, maximum \$20 million exploration tax credit, these expenses cannot be deducted as operating or capital expenses.

Once the mine goes into production there are no tax credits for ongoing exploration of the ore body. Moreover, exploration spending is not an allowable deduction when calculating net income. Most of the current operating mines in Alaska engage in ongoing exploration, reinvesting their profits in looking for more minerals to extend the life of their operations. Those investments are essential to a mine’s future, but are not considered a deductible operating expense.

The depletion allowance takes into account the high cost of developing an ore body into a producing mine. It is a business tax deduction similar to depreciation, but it applies to an ore deposit rather than equipment or facilities. Alaska’s depletion allowance, which can be taken as cost or percentage (15% of gross income) depletion, is identical to the federal version.

According to the IRS, depletion is the using up of natural resources by mining, drilling, quarrying stone, or cutting timber. The depletion deduction recognizes the ore body is an asset that is aging or being depleted.

Local Broad-Based Property Taxes Support Communities

Mines pay millions each year in property taxes in boroughs around Alaska. This is the appropriate, equitable, broad-based approach to local taxation.

	2018 Property Tax/ Payment in Lieu of Taxes	Borough
Fort Knox	\$8.2 million	Fairbanks North Star Borough
Greens Creek	\$1.7 million	City & Borough of Juneau
Kensington	\$1.4 million	City & Borough of Juneau
Red Dog	\$14.9 million	Northwest Arctic Borough (NAB)
Red Dog	\$8.0 million	Village Improvement Fund
TOTAL	\$34.2 million	

Unlike almost all other jurisdictions with significant mining sectors, the current tax system in Alaska allows local governments to place special taxes on mining outside of the property tax system. These special taxes, which could include severance taxes, would be in addition to (or in place of) a property tax. The potential for

⁸ 15 AAC 65.120 and 15 AAC 65.125
⁹ 15 AAC 65.125 (g)

a borough or municipality to impose, at any time, an unlimited and unpredictable severance tax on a resource it does not own creates serious business risk. It causes significant fiscal uncertainty for both existing and potential mines and detracts from the state's ability to ensure competitive tax systems, fair distribution of taxes, and benefits to the state as a whole.

Resource-specific taxes (whether oil, natural gas, fish, or minerals) should be decided by the state legislature, not local government, because of the statewide importance of resource development. In Alaska, oil and gas has this structure through statute, but mining does not.

This is ultimately an issue of state sovereignty. State control over resource-specific taxes is the norm in other U.S. states and around the world. When local governments receive the benefits of severance or other resource-specific taxes, the formula and funding are typically state controlled.

This is not a new problem nor is it specific to one mine. The threat of an onerous severance tax can impact the longevity of existing mines and the economic feasibility of new projects anywhere in the state. For this reason, the Alaska Minerals Commission has been recommending for more than ten years that this risk be eliminated by precluding local jurisdictions from imposing taxes, other than generally applicable property taxes, on mines.

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How does Alaska Incentivize Mining?

The State of Alaska provides only two tax incentives to attract development of new mines in Alaska: a 3.5 year exemption from the Alaska Mining License Tax and the Exploration Incentive Credit Program, a one-time maximum \$20 million exploration tax credit that has no value unless the mine goes into production. As Alaska is a high cost jurisdiction, both incentives can be critical to economic feasibility for some projects. To put these incentives into perspective, large mines take many years (even decades) to develop and the exploration, permitting, and pre-construction costs can run hundreds of millions—even billions—of dollars.

The 3.5 Year AMLT Exemption for New Mines can be Critical to Economic Feasibility

Alaska is a high cost jurisdiction, so both incentives can be critical to the economic feasibility for some projects.

The 3.5 year exemption from the Alaska Mining License Tax (AMLT) for a new mine recognizes that it takes a significant amount of exploration, development, and construction expenditures to bring new mines into production. Apart from the one-time \$20 million exploration tax credit, none of the exploration expenses, permitting costs, and few of the pre-construction expenses can be deducted or depreciated from income when the mine goes into production. It can take up to 20 years for cumulative cash flow to become positive.

All mines involve a start-up period that extends from initial commissioning through ramp-up to design operating levels. This process can take an extended period of time for complex projects such as a new mine and mill and add to the challenge of dealing with an unknown ore body. High production rates don't always equal profit. It is in the company's interest to ramp up to full production as quickly as possible to start to recoup their huge capital costs, but operational costs tend to be higher as the company works out efficiencies. Mature mines can more profitably mine lower grades because they have figured out those efficiencies.

Mining Exploration Tax Credit is Designed to Encourage Exploration & Production

The second incentive is the Exploration Incentive Credit Program (AS 27.30.010-27.30.99), which allows a maximum of \$20 million of pre-operational costs to be deducted from AMLT and/or state royalty. While the maximum exploration credit for a new mine is only \$20 million (and the exploration costs of a large mine can total hundreds of millions of dollars), it could still make a difference in the first years of production when the new mine is saddled with the huge capital costs incurred prior to production.

The mining exploration credit can only be taken if the mine goes into production. The credit is limited to \$20 million and must be used within 15 years of state approval.

According to the Department of Natural Resources, "The Exploration Incentive Credit Program was established to stimulate new mineral exploration activities in the State of Alaska." It is important to note that mining exploration investment does not necessarily result in a mineable reserve. These are risky dollars to spend. We heard so much about oil and gas exploration credits it is easy to assume the mining exploration tax credit is the same, but it is not.

- The biggest difference is that the credit can only be taken once the mine goes into production.
- The maximum a new mine can claim in exploration tax credits is \$20 million. This is the total amount for the mine, not an annual limit. It cannot be claimed more than once by different owners.
- The credit can only be used against 50% of the total tax liability or royalty in any given year and the credit must be claimed within 15 years of the start of production.

The actual amount spent on exploration prior to developing a large mine can be hundreds of millions of dollars. Apart from this \$20 million tax credit, the pre-production exploration and permitting expenses cannot be deducted as operating or capital expenses.

Major Metal Mining States Compete for Global Investment Dollars with Lower Tax Rates

When compared to the two largest metal mining states in the nation, Nevada and Arizona, Alaska already has the highest tax on metal mining as well as the highest corporate income tax rate. In order for Alaska to be competitive, attract mining dollars, and ultimately generate more state revenue, we should be looking at stability, not increased taxes.

	Metal Mining Net Profit/ Net Proceeds Tax	State Corporate Income Tax (highest rate)
Alaska	7%	9.4%
Nevada	5% ¹⁰	0%
Arizona	1.25% ¹¹	4.9%

¹⁰ Net Proceeds of Mining tax is gross revenue less deductions for cost of extraction, transport, marketing, delivery, fire and workers insurance, production, royalties and depreciation. <http://www.pwc.com/gx/en/industries/energy-utilities-mining/mining/tax/compare-taxes.html>

¹¹ 2.5% of 50% of difference between gross value and production costs on metals <http://www.azleg.gov/jlbc/10taxbook/10taxbk.pdf>

Mining Provides Far More than Taxes - It Benefits Alaska and Alaskans

Mining creates jobs and benefits communities, but the industry also helps broaden and stabilize Alaska's economic base. Many Alaskan communities, hundreds of Alaska businesses, and thousands of Alaska miners and their families depend on a healthy mining industry.

Jobs

Mining provides 4,500¹² jobs in mineral exploration and production as well as another 4,700 indirect jobs in industry support businesses. Most mine jobs are year-round family wage jobs, with an average salary of \$102,000 per year (not including excellent benefits). The combined payroll from all mining-related jobs in Alaska totaled over \$715 million in 2018. The footprint of mine employment is truly statewide because mines purchase equipment and services from hundreds of companies in Alaska.

In 2018, the mining industry provided 4,500 direct jobs with an annual average salary of \$102,000 plus benefits.

Community Impacts

People involved in mining live in more than 60 communities throughout Alaska. Our communities benefit from having high-wage mine employees among their residents. Those workers pay local property taxes and/or local sales taxes (where levied) and are often volunteers in community, civic, or school groups. The mining companies are also good corporate citizens giving millions of dollars each year to community groups, non-profits, and educational organizations.

Communities also receive direct financial benefits from local property taxes (or payment in lieu of taxes) levied on mine facilities and equipment, which helps support schools and local government services. See page 4 for details of the \$34.2 million paid to local governments in 2018.

Mining on Native Land Benefits all Alaska Native Corporations

The Alaska Native Claims Settlement Act has unique provisions that ensure subsurface wealth is shared among all Alaska Native Corporations. Under 7(i), 70% of the royalties from mineral development are shared among the 12 land-based regional corporations. Under 7(j), 50% of the 7(i) share is distributed by the regional corporation to the at-large shareholders and village corporations in its region.

• Red Dog: Contributing for more than 30 years

In 2018, NANA received \$355 million in net proceeds from Red Dog, of which \$221.5 million was distributed in 7(i) and 7(j) payments to other Alaska Native corporations and at-large shareholders. In total, between 1982 and 2018, NANA's Red Dog royalties were \$1.9 billion, of which more than \$1.2 billion was redistributed.

Red Dog's positive impact extends beyond royalty payments. NANA's innovative operating agreement with the Red Dog mine operator, Teck, requires jobs for shareholders and opportunities for contracts and partnerships for shareholder businesses. 55% of the year-round jobs at Red Dog are filled by NANA shareholders, including jobs with Teck Alaska, NANA companies, and other service providers.

¹² All economic impact numbers on this page are from The Economic Benefits of Alaska's Mining Industry, March 2019, McDowell Group, Inc.

• **Donlin Gold: Current and Future Benefits**

The Donlin Gold project is on property owned by Calista (subsurface) and The Kuskokwim Corporation (surface), and could generate substantial revenues for both corporations as well as other Alaska Native corporations through the revenue sharing provisions. Even though Donlin Gold is still in permitting, advance payments are being made to both Calista and The Kuskokwim Corporation. Calista Corporation has received millions of dollars in royalties and other revenue for mineral agreements, including lode exploration, placer gold production, and construction material sales.

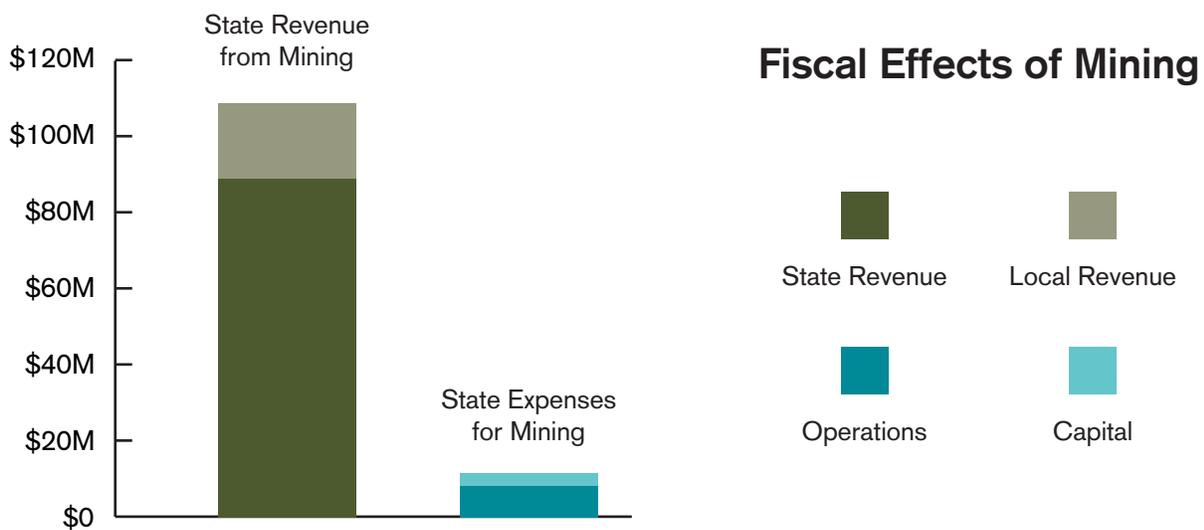
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Mining also Brings Infrastructure to Alaska

- Juneau’s hydroelectric power system started more than 100 years ago with generation plants built by the mining industry.
- Pogo paid for a 50 mile road and power transmission line.
- Kensington and Greens Creek mines built their own ports and roads.
- The Alaska Industrial Development and Export Agency (AIDEA), a state agency, built the Delong Mountain Transportation System to support the Red Dog mine with a port and road. The mine pays annual tolls to AIDEA that have generated a healthy 6.5% rate of return and more than repaid AIDEA’s initial investment.
- Looking forward, both Donlin Gold and Pebble, which are currently in permitting, plan to build natural gas pipelines. This could provide access to cheaper, cleaner energy for communities near the routes. Pebble’s surface transportation system will lower the costs of goods for villages around Lake Iliamna.

Mining Pays Its Way and More

In 2018, mining generated \$182.8¹³ million in payments to local governments and to the State of Alaska in the form of rents, royalties, fees and taxes. In a 2016 study, UAA’s Institute of Social and Economic Research found that mining has a high net benefit to the State’s General Fund.¹⁴



¹³Alaska Mineral Industry Report 2017, Department of Natural Resources, p. 8.
¹⁴Fiscal Effects of Commercial Fishing, Mining, & Tourism. What does Alaska receive in revenue? What does it spend?" Bob Loeffler and Steve Colt, Institute of Social and Economic Research, University of Alaska Anchorage, 2016, p. 2.

The figure on the previous page shows the annual revenues and expenses averaged over a five year period, 2010-2014. It is clear that the state receives far more revenue from mining than it expends managing the industry. The state's management costs are kept low through cost recovery or Reimbursable Service Agreements, which means the state charges the companies for its costs to permit, monitor, and oversee both exploration projects and producing mines. This leaves more mining revenue for the state's General Fund expenses like schools, public safety, and road maintenance. In 2018, the large metal mines and advanced projects paid nearly \$1 million to state government in Reimbursable Service Agreements.

Conclusion

Mining is different from other businesses because of the extended period of investment in exploration, permitting, and development, the significant capital requirements of a large, modern mine (which are exacerbated by Alaska's lack of infrastructure), and its dependence on prices set by world markets. The industry has moved to "all in sustaining costs" from "cash costs" to capture the reality that a return on invested capital does not occur when price exceeds production costs, but only when the capital invested is recovered. Investment in a new mine with a 20+ year operating life must be made without any assurance of what price will be received for the product over the mine life. Adding gross taxes, such as a severance tax, or raising the royalty rate increases the risk for the investor because it diminishes revenue without regard to whether the investor is making money, even on a cash operating (no capital return) basis.

To compete successfully for global exploration and development dollars, Alaska's tax structure at the state and local government levels must be stable, predictable, and competitive with other metal mining jurisdictions. Tax policy must also be compatible with the economic realities of the mining industry and the challenges of doing business in Alaska. Other than limiting the taxation authority of local government to broadly applicable property taxes, Alaska's current mineral taxation system does not need to be revised. The system is comprehensive and fair to the State and the industry.

Keeping our current operations strong and bringing new mines into production will increase the taxpayer base and result in more good jobs for Alaskans, more contracting and procurement opportunities for Alaska businesses, benefits for Native Corporations, and greater contributions to state and local government revenue.

The most effective public policy way to increase state revenue from mining is to have more mines in production, especially on state land.

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