Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Klehs	Analyst:	Anne Mazur	Bill Number:	AB 2442
Related Bills:	See Prior Analysis	Telephone:	845-5404	Amended Date:	May 26, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Petroleum Surtax/Motor Vehicle Fuel Tax Offset

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 6, 2006, STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would establish the following:

1. A petroleum surtax on corporations and individuals.
2. A motor vehicle fuel sales tax exemption.

SUMMARY OF AMENDMENTS

The May 26, 2006, amendments made the following changes:

- Deleted the provision that would have allowed an income tax credit for prescription drug costs incurred by seniors.
- Added an exemption provision to the Sales and Use Tax Law.
- Changed the dates during which the petroleum surtax would be operative.
- Added an exception to the petroleum surtax for small refiners.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	6/19/06
____ N	____ OUA	__X__ PENDING		

The Sales and Use Tax Law is administered by the Board of Equalization (BOE). Therefore, analysis is provided below for the motor vehicle fuel sales tax exemption only to describe the extent to which the Franchise Tax Board (FTB) would be impacted by that provision. Sections of the analysis of the bill as amended April 6, 2006, relating to the prescription drug credit, no longer apply. Except as provided below, the analysis of the bill as amended April 6, 2006, relating to the petroleum surtax, still applies.[1]

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to redistribute historically large petroleum business profits for the benefit of California citizens by providing gasoline sales tax relief at the pump.

POSITION

Pending.

1. PETROLEUM SURTAX

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately upon enactment. The bill specifies that it would apply for taxable years beginning on or after October 1, 2005, and before October 1, 2010.

THIS PROVISION

This provision of the bill would impose a 2% surtax on individuals and business entities, including corporations, engaged in business activities in the petroleum industry. The surtax would apply to net income in excess of $10 million. The surtax would be in addition to, but treated the same as, the current personal income tax or corporation franchise and income tax.

The term "taxpayer engaged in business activities in the petroleum industry" would mean a taxpayer that has more than 50% of its gross business receipts, as defined, derived from conducting one or more qualified business activities. Those activities would include petroleum producing, refining, wholesaling, and retailing activities, as described in specified sections of the North American Industry Classification System (NAICS) Manual published by the United States Office of Management and Budget, 2002 Edition. This provision would not apply to small refiners, as defined.

[1] Concerns described in the "Technical Considerations" section of the analysis for the bill as amended April 6, 2006, relating to the petroleum surtax were resolved by the April 18, 2006, amendments. Because the April 18, 2006, amendments were technical in nature, a departmental analysis was not required.

In the case of a unitary group required to be included in a combined report, the 50% test would apply at the group level.

In the case of pass-through entities (PTE), the bill specifies that the 50% test would apply at both the entity and investor level. An investor in a PTE that both meets the 50% test and has net income in excess of $10 million would be subject to the surtax on the investors distributive or pro rata share of that income. In addition, any PTE that engages in petroleum activities must separately state the gross business receipts of those activities regardless of whether the 50% test is met at the entity level. If an investor in a PTE meets the 50% test, the investor would be required to aggregate its distributive or pro rata share of net income for all the investor's PTEs – to the extent the PTE net income did not exceed the $10 million threshold at the entity-level – along with the investor's net income from other sources for purposes of applying the $10 million threshold.

This provision would authorize FTB to issue regulations and be repealed by its own terms on December 31, 2011.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Implementation of the surtax for taxable years beginning on or after October 1, 2005, would be problematic if this bill is enacted after tax returns and tax for that year are due. The department would need to develop and implement transitional procedures, including noticing taxpayers and creating new and revising existing forms, for reporting the tax due for the 2005 taxable year. To provide clarity for the department and taxpayers, the bill should be amended to include transitional provisions to address the payment of the surtax for the 2005 taxable year, such as a payment due date that is 60 days after the date of enactment, with interest accruing from that date. In the alternative, the author may want to consider making the bill operative for taxable years beginning on or after January 1, 2006.

This bill would require modification of existing individual and business entity tax forms and instructions for computing and reporting the surtax.

This bill also would require modification of systems, including the individual and business entity accounting, nonfiler, return processing and cashiering systems, to account for and issue assessments of the additional tax. Most of these changes could be accomplished during the normal annual update.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the petroleum surtax provisions of the bill would result in the following revenue gains.

Revenue Impact of Petroleum Surtax Enactment Assumed After June 30, 2006 ($ in Millions)		
2006/07	2007/08	2008/09
+ $120	+ $150	+ $190

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion

Micro-level data on a sample of California petroleum producers, refiners, wholesalers, and retailers were used to estimate the revenue impact of this proposal. The state net incomes (SNIs) of these taxpayers were projected into the future using financial information from public-domain sources and expert judgment. A surtax of 2% was then applied to the excess of SNI in any taxable year over $10,000,000. It was assumed that this proposal would be enacted sometime after June 30, 2006.

For the 2006 taxable year, excess SNIs for California corporate petroleum producers, refiners, wholesalers, and retailers is forecast[2] to be approximately $5.7 billion resulting in $115 million ($5.7 billion × 0.02) of tax revenue. The inclusion of personal income taxpayers would add another 5% to the revenue impact resulting in a total gain for the first fiscal year of $120 million.

The exception for small refiners to the petroleum surtax provision does not materially impact the revenue estimate for that provision. Using information on California refineries from the California Energy Commission and company-level data on state net incomes, it was determined that the previous estimates still apply. Small refiners, as defined, are estimated to generate 0.20% of the tax revenue impact. A reduction of 0.20% is less than the rounding error in the original estimate.

As described for the motor vehicle fuel sales tax exemption, the BOE would be required to determine and implement a revenue reduction equal to, and in order to offset, the revenue increase attributable to the petroleum surtax based on estimates provided by FTB.

[2] Projected income for 2006 is based on data published in The Value Line Investment Survey.

2. MOTOR VEHICLE FUEL SALES TAX EXEMPTION

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately upon enactment. The bill specifies that it would apply for period commencing on January 1, 2007, and ending on December 31, 2010.

ANALYSIS

THIS PROVISION

This provision would provide a sales and use tax exemption with respect to motor vehicle fuel, as defined, measured by the amount of revenue generated by the petroleum surtax. The exemption would be applied by reducing the sales or use tax imposed on each gallon of motor vehicle fuel by an offset amount. The "offset amount" would mean the amount necessary to reduce the sales or use tax revenues on motor vehicle fuel by an amount equal to the increase in revenues derived from the petroleum surtax provisions for specified periods as follows:

- For January 1, 2007, through June 30, 2007, the offset amount would be based on the revenue increase from the petroleum surtax for October 1, 2005, through June 30, 2007.
- For the fiscal year beginning July 1, 2007, and each fiscal year thereafter until the provision is repealed, the offset amount would be based on the revenue increase from the petroleum surtax for the same fiscal year.

FTB would be required to cooperate with BOE in providing estimates of revenues from the petroleum surtax to facilitate BOE in implementing this provision.

This provision would be repealed by its own terms on December 31, 2011.

IMPLEMENTATION CONSIDERATIONS

Except for the requirement for FTB to provide revenue estimates, this provision would be administered by the BOE and, therefore, implementing this bill would not significantly impact the department's programs and operations.

As noted, this bill would require FTB to cooperate with BOE in providing estimates of revenues from the petroleum surtax required to implement this provision. BOE would also be required to take into account the actual amount of revenues derived in prior years in order to ensure that the sales tax offset amount equals petroleum surtax revenue. FTB is constrained in providing actual amounts for the following reasons:

- For the 2006 taxable year, FTB would be unable to determine the amount of the surtax reported on calendar year returns until approximately 6 months following the October 15, 2007 extended due date of returns.
- FTB would be unable to translate taxable year revenue impact to fiscal year impact, as appears to be required by this bill. This difficulty arises because tax payments made for a tax year are made in more than one fiscal year. It is unfeasible to determine to what extent the payments in any particular fiscal year would be adjusted to account for the proposed surtax.

Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

LEGISLATIVE STAFF CONTACT

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