Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Klehs Analyst: Anne Mazur Bill Number: AB 673

Related Bills: See Prior Analysis Telephone: 845-5404 Amended Date: January 26, 2006

Attorney: Patrick Kusiak Sponsor: ______

SUBJECT: Petroleum Windfall Profits Penalty

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________.

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

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as amended January 5, 2006.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ____________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED January 5, 2006 STILL APPLIES.

_____ OTHER – See comments below.

SUMMARY

This bill would impose a penalty on windfall profits realized by petroleum producers and refiners.

SUMMARY OF AMENDMENTS

The proposed amendments:

- Would add a growth factor to the computation of base year adjusted net income for purposes of determining the amount of windfall profits subject to the penalty.
- Extend the repeal date of the provisions of this bill by one year by revising that date from January 1, 2009, to January 1, 2010.

Certain technical and policy concerns previously identified by department staff were resolved by these amendments. As such, these sections have been restated below without those concerns. The This Bill and Economic Impact sections of this analysis have also been revised to reflect these amendments. Except for the items below, the remainder of the department's analysis of the bill as amended January 5, 2006, still applies.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	3/9/06
_____ N	_____ OUA	__X__ PENDING		

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would establish the Petroleum Windfall Profits Penalty in an amount equal to 2.5% of the windfall profits realized by petroleum producers and refiners. Taxpayers would be subject to the penalty if they are engaged in the business of petroleum production or refining as described in designated codes of the 2002 edition of the North American Industry Classification System Manual (NAICS), i.e., Codes 211 and 32411 for petroleum producers and petroleum refiners, respectively.

"Windfall profits" would be defined as adjusted net income over base year net income. "Adjusted net income" would mean business income apportioned to California before any net operating loss (NOL) deduction. The base year adjusted net income would be a moving average of the taxpayer's business net income before NOL deductions for the five preceding years, adjusted by a growth factor. The growth factor would equal the percent change of growth in the quantity of gallons of petroleum sold in California by the taxpayer from the previous year.

The bill would provide FTB with the authority to prescribe rules and regulations to implement the provisions of the bill, including any rules to take into account mergers, acquisitions, and divestitures in the computation of the base year adjusted net income.

The bill specifies that the penalty would apply to taxable years beginning on or after January 1, 2005 and before January 1, 2009. The bill also provides that the provision would be repealed on January 1, 2010.

TECHNICAL CONSIDERATIONS

The bill specifies that the penalty would be imposed in addition to any other "tax" imposed under Parts 10 or 11 of the Revenue and Taxation Code (R&TC). Staff suggests that the bill be amended to specify that the penalty also would be imposed in addition to any other "penalty" imposed under those parts, or Part 10.2.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, would result in the following gains:

Revenue Impact of AB 673 Enactment Assumed After June 30, 2006 in millions		
2006-07	2007-08	2008-09
+$135	+$65	+$85

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

Revenue Discussion

Micro-level data on a sample of California petroleum producers and refiners were used to estimate the revenue impact of this proposal. The incomes of these taxpayers were projected into the future using financial information from public-domain sources and expert judgment. A penalty of 2.5% was then applied to the excess of income in any taxable year over the average of the incomes for the five immediately preceding taxable years. Staff assumed that this proposal would be enacted sometime after June 30, 2006.

For the 2005 tax year, the apportioned income for California petroleum producers and refiners is forecast[1] to be approximately $6.9 billion. The 2005 gross base year adjusted net income is forecast to be approximately $3.3 billion. The estimated “windfall profits” are, therefore, approximately $3.6 billion. Multiplying the “windfall profits” by the 2.5% penalty rate generates a revenue gain of approximately $90 million. As noted below, penalty payments attributable to 2005 would not be due until sometime in the 2006-07 fiscal year. Both penalty payments attributable to taxable year 2005 and attributable to taxable year 2006 would be realized in the 2006-07 fiscal year.

For purposes of this estimate, department staff assumed the following:
- The penalty payment would be due on the date prescribed for paying tax (generally the original due date of the return), unless the due date occurs before enactment of this bill. In that case, the payment due date would be some date on or after the enactment date.
- No estimated tax penalties would be assessed.
- This bill will be amended to provide for each of these items expressly.

ARGUMENTS/POLICY CONCERNS

This bill could be viewed as inequitable as it would impose a penalty on large profits reported by a single industry that already is subject to state taxation to the extent income is derived from California sources.

[1] Projected income for 2005 is based on data published in The Value Line Investment Survey.

If a taxpayer or unitary group of taxpayers conducts business activities other than petroleum production or refining, the penalty would apply to "windfall profits" attributable to those other activities as well.

The bill defines "windfall profits" with reference to the excess of adjusted net income over base year adjusted net income. Current year net income, prior year net income, or the base year average could be negative amounts, i.e., losses. Therefore, the excess of current year apportioned business over the base year amount could be an amount that is greater than positive business income apportioned to California. For example, if a taxpayer's adjusted net income is $10 million and the base year adjusted net income is negative $2 million, then the windfall profit upon which the penalty would apply is $12 million.

LEGISLATIVE STAFF CONTACT

Anne Mazur
Franchise Tax Board
(916) 845-5404
anne.mazur@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov