1980

TAXATION. SURTAX.

11 Taxation. Surtax—Initiative Statute

Official Title and Summary Prepared by the Attorney General

TAXATION. SURTAX. INITIATIVE STATUTE. Levies a 10-percent surtax on the business income from California sources of energy businesses (except public utilities) whose principal activity is the obtaining, processing, distributing or marketing of oil, gas, coal, or uranium. Allows a tax credit against surtax of $0.50 for every dollar invested in California after January 1, 1979, to increase the production or refining of California crude oil or gas over 1978 base levels. Requires that surtax proceeds be used to fund increased bus and rail service for Californians and to develop alternative transportation fuels. Prohibits businesses from passing surtax on to consumers. Fiscal impact on local or state governments: Depending on exact amount of tax credits claimed in each year, estimated state revenue increases of $150 to $420 million in 1980–81, and $165 to $470 million in 1981–82 could occur. Under existing statutes, approximately one-half of increases would be distributed to local governments for improvement of public transit services.

Analysis by Legislative Analyst

Background:

Taxation of Corporations. California currently imposes a tax on the taxable income of all corporations that do business or own property in this state. The present tax *rate* of 9.6 percent is applied to the taxable income of nonfinancial corporations.

In many cases, businesses operating inside California also have operations in other states and other countries. For these businesses, the California Franchise Tax Board allocates a share of the corporations' nationwide or worldwide income to California, based on California's share of the businesses' overall property, payroll and sales.

Transportation Planning and Development Account. The Transportation Planning and Development Account in the State Transportation Fund provides funds to support a variety of state and local transportation-related projects, including local transit assistance, and alternative motor vehicle fuel programs. This account is currently funded by annual transfers of sales tax revenue and is estimated to have $139 million available for support of state and local transportation-related projects in 1980–81.

Proposal:

This initiative would:

(1) Levy a 10-percent energy surtax on the taxable income of energy-related businesses operating in California.

(2) Allow affected corporations to take a credit against the surtax for investments made in California which increase the production or refining of crude oil or gas.

(3) Require that all proceeds from the surtax be deposited in the Transportation Planning and Development Account.

The surtax would apply to all corporations whose "principal activities" are energy related. The measure defines "principal activity" to mean that more than 50 percent of a corporation's total sales result from energy-related products. The surtax *would not* apply to public utilities whose principal activity is the obtaining, processing, distributing, or marketing of oil, gas, coal or uranium, and corporations whose principal activity is the production or sales of alternative sources of energy such as geothermal, solar or wind.

The energy surtax would be in addition to the normal corporation tax rate of 9.6 percent. Thus, most affected corporations would be subjected to a 19.6-percent tax rate, which would be applied to California's share of the affected corporations' worldwide income. The first $5 million of a corporation's worldwide income would be exempt in determining the earnings which would be subject to the surtax. However, this exclusion would be reduced by $1 for every dollar of worldwide business income in excess of $5 million. Thus, for example, a corporation with $6 million in income would have an exclusion of $4 million and would have to pay the surtax on California's share of the remaining $2 million of worldwide income. Corporations with incomes over $10 million would receive no exclusion and would have to pay the surtax on California's share of their *total* profits.

A credit would be allowed against the surtax for investments made by corporations in California to increase oil or gas production above their 1978 levels. Such investments would have to be approved by specified state agencies.

The credit would be equal to 50 percent of the amount invested to increase oil or gas production or refining. Thus, for every dollar invested to increase oil or gas production or refining in California, corporations could reduce their surtax by 50 cents. The total amount of the credit taken in any one year would be limited to 50 percent of the total surtax for that year; however, any excess or unused credits could be used by corporations to offset the surtax in future years.

The proposal would not allow corporations to pass the surtax on to consumers. The proposal, however, does not provide a method for enforcing this provision.

Fiscal Effect:

Increased State Revenues. Because (1) we have no basis for estimating the level of profits which will be realized by corporations in energy-related fields in the future, and (2) we do not know to what extent corporations affected by this initiative would utilize the investment credits, we cannot make a precise estimate of the surtax revenues which would occur as a result of this initiative. However, based on projections of the reported profits of energy-related corporations through 1979, adoption of this proposal could increase revenues to the state by $300 million to $420 million in 1980–81 and $330 million to $470 million in 1981–82. These estimates make no allowance for any reduction in surcharge revenues because of the credits allowed under this initiative. If the *maximum* credits were utilized, the net revenue increase could total $150 million to $210 million in 1980–81 and $165 million to $235 million in 1981–82.

Effect on State and Local Governments. Because the initiative specifies that proceeds from the surtax are to be deposited in the Transportation Planning and Development Account, the moneys from this tax would have to be distributed to various state and local entities according to existing laws.

On this basis, over 35 percent of the total increase in revenues resulting from this surtax would be distributed to California's four major population areas—the San Francisco Bay area, San Diego County, Los Angeles County, and Orange County—and about 10 to 15 percent of the revenues would be distributed throughout other areas of the state. These funds would be earmarked for the improvement of public transit services.

The remaining 50 percent of the proceeds would be available to be appropriated by the Legislature for general transportation purposes, including research for developing alternative transportation fuels. Because these funds are available for general appropriation, it is not possible to predict how the remaining revenues would be distributed among the state and local governments.

As a result of the passage of Proposition 4 by the voters last November (which puts a limit on certain appropriations by state and local governments), it is possible that some local governments would not be able to spend all of the proceeds from this surtax without reducing expenditures for other activities.

Text of Proposed Law

This initiative measure proposes to add sections to the Revenue and Taxation Code; therefore, new provisions to be added are printed in *italic type* to indicate that they are new.

PROPOSED LAW

Section 1. Chapter 2.8 (commencing with Section 23480) is added to Part 11 of Division 2 of the Revenue and Taxation Code, to read:

Chapter 2.8. Oil Profits Tax

23480. We, the people of California, do hereby levy an energy surtax on the excess profits of oil companies operating within this state.

23481. The surtax shall apply to all energy businesses, except public utilities, whose principal activity is the obtaining, processing, distributing or marketing of oil, gas, coal, or uranium, but not of alternative sources of energy, as defined by the California Energy Commission such as solar, geothermal, wind, or biomass. Principal activity means more than fifty percent (50%) of sales as determined by the California Franchise Tax Board pursuant to Chapter 17 or 18 of the Bank and Corporation Tax Law.

23482. The surtax shall be imposed at the rate of ten percent (10%) on the business income from California sources.

23483. In determining the amount of business income from California sources subject to the surtax, the sum of five million dollars ($5,000,000) shall be excluded from worldwide business income. However, the amount excluded shall be reduced by one dollar ($1.00) for each one dollar ($1.00) of worldwide business income in excess of five million dollars ($5,000,000).

23484. A credit of fifty cents ($.50) shall be allowed against this surtax for every dollar ($1.00) invested in California after January 1, 1979, to increase the production or refining of California crude oil or gas over 1978 base levels. Credits for 1979 may be allowed under rules adopted by a two-thirds vote of the Legislature. In no case shall the tax credit allowed exceed fifty percent (50%) of the surtax due. Tax credits in excess of the fifty percent (50%) allowed may be carried over to subsequent years.

23485. Collection of the surtax shall be the responsibility of the California Franchise Tax Board. For purposes of applying the credit allowed under Section 23484, the California Energy Commission shall certify investments made to increase refining of California crude; the Division of Oil and Gas, of the Department of Conservation, shall certify investments made in new or increased production.

23486. All proceeds from the surtax shall be deposited in the Transportation Planning and Development Account: to fund increased bus and rail service for Californians and to develop alternative transportation fuels.

23487. The energy surtax and estimated surtaxes shall be paid at such time and in such manner as required by state law for other taxes due under the Bank and Corporation Tax Law.

Section 2. The Legislature, by a two-thirds vote of the members of each house, may strengthen but not weaken the provisions of this measure.

Section 3. This measure shall apply to income years beginning on and after January 1, 1980.

Section 4. Businesses subject to this surtax shall not pass this surtax on to the consumer.

Section 5. If any section, part, clause, or phrase hereof is for any reason held to be invalid or unconstitutional, the remaining sections shall not be affected, but shall remain in full force and effect.

Argument in Favor of Proposition 11

TAX BIG OIL.

"Reasonable profits, yes. Greed, no."

In 1979, big oil companies made the highest profits in history. The *average* increase in 1979 profits was *100 percent* over 1978.

At the same time, the price of gasoline soared to a record high: increasing almost a penny a gallon a week. And every *one penny* at the pumps equals another *one billion dollars* to big oil.

More and more Californians can no longer afford to drive to work. When gasoline hits two dollars a gallon, public transit will no longer be a luxury. It will be a necessity.

It's time to fight back. Sure, big oil is entitled to a reasonable level of profit. But this year they're eating up more than their share.

PROPOSITION 11:

- Puts a 10-percent surtax on the excess profits of big oil companies.
- Exempts firms earning less than $5 million a year.
- Gives a 50-percent tax credit for increased production of refining of California oil and gas.
- Raises $125 to $200 million in new state revenues each year for *increased bus service, increased rail service,* and development of *alternative fuels,* like ethanol and methanol.
- Prohibits passing tax on to consumers.

PROPOSITION 11 WILL SAVE ENERGY.

Energy conservation is the most immediate solution to our energy problem. And, since most energy is consumed by the automobile, mass transit is the most effective means of conserving.

By providing $125 to $200 million in new state funds for mass transit, Proposition 11 will make a dramatic contribution to easing our energy problem.

PROPOSITION 11 WILL CREATE JOBS.

Proposition 11 will stimulate the economy by creating 1,650–5,500 new jobs each year. For this reason, Proposition 11 enjoys the *strong support* of organized labor throughout the state.

PROPOSITION 11 WILL HELP SAVE CITIES.

Cities depend on good, convenient public transit.

California cities could use the $200 million provided by Proposition 11 for:

- New bus lines; weekend and evening bus service.
- New light rail for *San Diego.*
- New light rail for the *Sacramento/Folsom* corridor.
- Commuter rail from *Oxnard* and *San Bernardino* to *Los Angeles.*
- Subway for the *Wilshire corridor.*
- Transit connecting *San Francisco* and the *South Bay.*
- Light rail for the *Santa Clara/Guadalupe* corridor.
- Improvements for the *San Francisco Muni.*

PROPOSITION 11 WILL HELP CALIFORNIA BUSINESS.

California's vast energy reserves have gone largely undeveloped because oil companies have never had sufficient fiscal incentive to go after them.

Proposition 11 provides this incentive by giving oil companies a 50-percent tax credit for any investment made *in California* to increase production or refining of crude oil or natural gas.

This credit will help deliver the oil and gas we need—and create even more jobs.

PROPOSITION 11 CREATES NO NEW BUREAUCRACY.

Proposition 11 will create no new state bureaucracy. So, all revenues collected go immediately to more buses and trains.

This tax merely adds 10 percent to an existing tax—easily calculated and collected by existing staff.

TAX BIG OIL—VOTE "YES" ON PROPOSITION 11.

To tax excess oil profits, to save energy and to create jobs, we urge our fellow Californians to vote *"yes"* on Proposition 11.

EDMUND G. BROWN JR.
Governor

DIANNE FEINSTEIN
Mayor of San Francisco

BILL PRESS
Chairman, Citizens to Tax Big Oil

Rebuttal to Argument in Favor of Proposition 11

Backers of Proposition 11 neglect to tell you that *all* California business income of affected companies would be subject to the surtax. It would more than double their income tax on such nonenergy activities as farm products, shipping and construction.

Many companies subject to this surtax do not deal exclusively in energy.

Claims by Governor Jerry Brown and other proponents that Proposition 11 would create new jobs are wholly unsupported.

Their initiative, in fact, offers tax savings to companies that move payrolls and facilities out of California and discourages others from locating here. This is appalling in view of Jerry Brown's own administration's report that we need more than a quarter-million new jobs annually—just to keep California's unemployment rate from increasing!

Backers of this scheme claim the surtax is aimed at "big oil companies." Their own initiative shows this is nonsense. It would also apply to smaller, independent companies and could tax their growth at twice the rate of big companies'.

Proposition 11's tax credit is a scam. The state takes $1 and returns 50 cents. Revenue lost to taxes can't produce more energy—ridiculous in view of our need for energy independence.

Reason for their scheme, says Jerry Brown: Oil companies are "eating up more than their share" of profits. The facts: In 1979, the largest five oil companies averaged 4.9 percent profit on sales. The largest five nonoil industries that have reported averaged 5.8 percent!

Californians can't afford Proposition 11. Vote NO.

MILTON FRIEDMAN
Nobel Laureate
Hoover Institution, Stanford University

KIRK WEST
Executive Vice President
California Taxpayers Association

MORRIS S. FRANKEL
President
California Independent Producers Association

Argument Against Proposition 11

At the moment we are struggling to reduce our energy dependence on foreign nations, Proposition 11 would decrease the funds available for exploration and development of new domestic sources.

Proposition 11 is a political scheme that originated with Governor Jerry Brown, is endorsed by him and is sponsored by one of his closest political lieutenants.

The proposed surtax would put into the hands of bureaucrats millions of dollars that should be spent by private industry to develop new sources of energy—from expansion of solar and geothermal power to increases in petroleum productions.

It would discourage private industry development and put the state into the energy business.

It is discriminatory. The growth of some smaller companies could be penalized twice as severely as that of big companies.

Growing California must generate tens of thousands of new jobs every year, just to keep unemployment from increasing. Yet, Proposition 11 would provide tax savings to companies that cut their California payrolls and would discourage other firms from establishing job-creating facilities here.

Proposition 11's sponsors claim it would merely impose a surtax on the *excess* profits of the big oil companies. That simply is not true. The additional tax—which would more than double the present business income tax—would apply to all California income, not to excess profits. Nor would it apply only to the major oil companies.

Also, it would not apply solely to energy sales.

For example, the combined income of a farming company with 51 percent of its income from oil production on its land ould be subject to this surtax. It could apply to sales of grapes, peaches, cotton and other nonenergy products as well as oil.

But this company's competitors without energy involvement would pay no surtax. This is discriminatory and unfair and, in some cases, could encourage *reduction* of energy production to avoid the surtax liability.

Proposition 11 is riddled with flaws that would result in long and expensive lawsuits.

For example, the initiative says the surtax shall be imposed on the *"business income"* from California sources of companies subject to the tax. It fails to specify *gross* or *net* income. A written Legislative Counsel opinion says it would apply to gross income. Thus, a company with less than 10 percent profit could pay it all in surtax and face bankruptcy.

Some legal experts feel it would apply to *net.* This conflict is unresolved.

There is a serious legal question whether all the surtax income could be spent for mass transit and alternate fuel, as mandated by the initiative. The measure ignores the spending limitations placed in the California Constitution by the "Spirit of 13" amendment approved by the voters last November.

Could the state legally spend an additional $400 million annually for mass transit without reducing its spending for other purposes, such as education, health and law enforcement?

This punitive political scheme that threatens California's employment and development of energy sources must be stopped. We urge you to vote NO on Proposition 11.

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Rebuttal to Argument Against Proposition 11

Big Oil wants us to believe they're spending their enormous profits exploring for more energy.

In fact, a large portion of those profits have *not* gone for new exploration—but rather to acquire other *non-energy-related businesses.*

A *few* recent examples:

- Mobil bought *Montgomery Ward.*
- Arco bought the *London Observer.*
- Gulf bid $30 million to buy *Ringling Brothers Barnum and Bailey Circus.*

How much oil is Mobil going to find under Montgomery Ward? Clearly, Big Oil is more interested in profits than production. We get Big Lies from Big Oil.

For example, the opponents of Proposition 11 say:

- That there is confusion about whether the tax applies to gross or net income. In fact, this tax is merely an addition to an *existing* tax that is applied to *net* income—*not* gross income.
- That Proposition 11 will hurt small companies. But according to the State Franchise Tax Board *no more than 50 major integrated oil companies in California will be subject to the tax.*
- That Proposition 11 is in conflict with the Gann spending limit initiative. But the California Attorney General has already stated that Proposition 11 will have no significant impact on state and local spending.

Even the big oil companies agree that Big Oil will *not* simply pass the tax on to the consumer through higher gas prices. If they did, they would be in violation of both state and federal law.

Don't be fooled by Big Oil. Remember these hard facts:

1. Gasoline prices are higher than ever.
2. Big Oil profits are the highest in history.
3. California needs more transit—and Big Oil can afford to help pay the cost.

Please—vote *"YES"* on Proposition 11.

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