October 6, 2011

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Dawn McFarland
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative concerning oil and gas severance taxes (A.G. File No. 11-0033, Amdt. #1S).

Background

Oil- and Gas-Related Taxation in California. Oil and gas producers pay state income taxes. Oil producers also pay a regulatory charge on production in the state or in state waters. Also, property owners pay local property taxes on the value of both extraction equipment such as drills and pipelines and underground oil and gas reserves.

Proposal

New Oil and Gas Severance Tax. This measure imposes a 10 percent tax on the value of all oil and gas extracted in California or its state offshore waters, which extend out three miles from the coastline. Oil and gas produced in federal waters would be exempt, and "stripper" wells capable of producing less than ten barrels a day would be exempt if the price of oil from those wells is $50 a barrel or lower. The measure states that the costs of the tax may not be passed on to consumers and empowers a state agency to investigate attempts to "gouge" consumers.

New Tax Revenues to Fund Education. The new revenues generated by the proposed severance tax would be dedicated to a state government account to fund various state and local education expenses. Specifically, the severance tax revenues would be divided as follows:

- 40 percent to K-12 "direct classroom instruction," to be allocated at the discretion of the state's Superintendent of Public Instruction.
- 20 percent to classroom instruction of community college districts, to be allocated at the discretion of the Board of Governors of the state's community college system.
- 20 percent to classroom instruction of the California State University (CSU) system, to be allocated at the discretion of the CSU Board of Trustees.
- 10 percent to classroom instruction of the University of California (UC) system, to be allocated at the discretion of the UC Board of Regents.

- 10 percent to student aid programs of the California Student Aid Commission (CSAC), to be split between (1) Cal Grants (a state-funded financial aid program for eligible low- and middle-income students) and (2) a scholarship program for students from households with an average annual household income of $50,000 or less.

While this measure dedicates the severance tax revenues to the education activities described above, it also would allow the Superintendent of Public Instruction, the community college and university boards, and CSAC to allocate the funds attributable to their respective activities to the state's General Fund (the state government's main operating account, which is available for appropriation by the Legislature for any state purpose) in any given year. The measure also declares that the revenues dedicated to education activities must supplement and, therefore, not supplant existing levels of state funding.

Fiscal Effects

New Revenues. The 10 percent severance tax would likely generate between $1.5 billion and $2.5 billion annually in its first years. The range of revenues is due to the wide fluctuation in oil and gas prices.

Effects on Education Funding. The severance tax revenues would likely increase overall state funding to K-12 school districts, community college districts, CSU, UC, and student aid programs. While the measure states that severance tax revenues may not supplant existing levels of state funding, it is unclear how such a provision can be enforced, especially for higher education and student aid programs.

Other Fiscal Effects. Relatively minor economic changes related to the severance tax likely would result in reductions of other state and local revenues such as property and income taxes—perhaps totaling in the low tens of millions of dollars per year. State departments also would have to spend a few million additional dollars each year to administer the new tax.

Summary. This measure would have the following major fiscal effect:

- Increased state revenues from a new oil and gas severance tax of $1.5 billion to $2.5 billion per year. These revenues would be allocated to education and would likely result in increased state funding of various education programs.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance