STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**04/22/10**	Bill No:	**AB 656**
Tax:	**Oil and Gas Severance**	Author:	**Torrico**
Related Bills:	**AB 1604 (Nava)**		

This analysis will only address the bill's provisions which impact the State Board of Equalization (BOE).

BILL SUMMARY

This bill would impose an oil and gas severance (severance) tax upon any producer for the privilege of severing oil or gas from the earth or water in this state for sale, transport, consumption, storage, profit, or use. The proposed new tax would be administered and collected by the BOE.

SUMMARY OF AMENDMENTS

Since the last analysis, the bill was rewritten to again be an oil severance tax, and not simply a report on the potential revenue generated by such a tax.

ANALYSIS

CURRENT LAW

Under current law, the following taxes, fees, and assessments relating to oil and gas are imposed:

Regulatory Assessment. The Division of Oil, Gas, and Geothermal Resources of the Department of Conservation imposes a fee on each barrel of oil and each 10,000 cubic feet of natural gas produced. Producers of oil and gas are required to pay the fee, which is currently at a rate of $0.0790758 per barrel or 10,000 cubic feet. The fees are assessed for purposes of financing the regulatory work of that division. (Article 7 (commencing with Section 3400) of Chapter 1 of Division 3 of the Public Resources Code.)

Property Tax. Under Property Tax Law, with respect to oil in the ground, "proved reserves" are subject to property tax assessment by county assessors (Property Tax Rule 468). In this respect, for property tax purposes, Public Resources Code Section 3234 gives both county assessors and the BOE access to monthly production reports related to the regulatory assessment filed with the Department of Conservation by oil well owners pursuant to Public Resources Code Section 3227.

Oil Spill Prevention and Administration Fee. Existing law also imposes an Oil Spill Prevention and Administration Fee of $0.05 per barrel upon persons owning crude oil when it is received at a marine terminal from within the state, which is collected by the marine terminal operator. The fee is also imposed on operators of pipelines transporting oil in the state across, under, or through marine waters. This BOE-administered fee is deposited into the Oil Spill Prevention and Administration Fund. (Part 24 (commencing with Section 46001 of Division 2 of the Revenue and Taxation Code.)

Oil Spill Response Fee. The BOE also collects an oil spill response fee as required by Government Code Section 8670.48. A uniform oil spill response fee is paid by specified marine terminal operators, pipeline operators, and refiners, in an amount not exceeding $0.25 per barrel of petroleum product or crude oil. The BOE collects the fees and deposits all proceeds into the Oil Spill Response Trust Fund, but only until a maximum of $50 million is available to react to a spill. No fees are currently being collected since the Oil Spill Response Trust Fund is at its maximum.

Sales and Use Tax. Currently, the Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code) imposes a sales or use tax on the gross receipts from the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of gasoline and diesel fuel are generally subject to an 8.25 percent statewide state and local sales or use tax. In addition to the state portion of the sales and use tax rate, the local taxes are imposed by cities and/or counties and are administered by the Board.

Beginning July 1, 2010, sales and purchases of gasoline will be exempt from the State General Fund (6%) portion of the sales and use tax rate.

Excise Taxes. Under the Motor Vehicle Fuel Tax Law, the state imposes an excise tax of $0.18 per gallon on the removal of gasoline at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person. The Diesel Fuel Tax Law also imposes an excise tax of $0.18 per gallon in a similar manner.

Beginning July 1, 2010, an additional $0.173 per gallon excise tax will be imposed on gasoline (except aviation gasoline). This surtax is subject to a rate adjustment mechanism that seeks to balance the revenues from the additional excise taxes on gasoline against the state General Fund sales and tax exemption on gasoline.

Federal law imposes an additional per gallon tax on gasoline and diesel fuel of 18.4 cents and 24.4 cents, respectively.

Natural Gas Surcharge[1]. Under existing law, Article 10 (commencing with Section 890) to Chapter 4 of Part 1 of Division 1 of the Public Utilities Code imposes a surcharge on all natural gas consumed in this state.

The surcharge applies to all consumption, except natural gas used to generate power for sale, resold to end users, used for enhanced oil recovery, utilized in cogeneration technology, or produced in California and transported on a proprietary pipeline.

PROPOSED LAW

Among other things, this bill would add Part 21 (commencing with Section 42001) to Division 2 of the Revenue and Taxation Code to enact the Fair Share for Fair Tuition Act (Act) to impose a severance tax upon any producer for the privilege of severing oil or gas from the earth or water in this state for sale, transport, consumption, storage, profit, or use. The 12.5 percent tax rate would be applied equally to all portions of the gross value of the product.

Except as provided, the severance tax would be imposed upon the entire production in this state, regardless of the place of sale or to whom sold or by whom used, or the fact that the delivery may be made to points outside the state.

[1] Natural gas surcharge rates can be found at: http://www.boe.ca.gov/pdf/boe500ng.pdf

The severance tax would be in addition to any other taxes imposed by law, including, without limitation, any ad valorem taxes imposed by the state, or any of its political subdivisions, or any local business license taxes that may be incurred as a privilege of severing oil or gas from the earth or water or doing business in that locality.

Exemptions. The bill would exempt from the severance tax oil or gas produced by a stripper well in which the average value of oil or gas is less than three-quarters of the average gross value of the product as of the first day of the previous calendar quarter. A stripper well would be defined to mean a well that has been certified, as described, by the Division of Oil, Gas, and Geothermal Resources in the Department of Conservation as an oil well incapable of producing an average of more than 10 barrels of oil per day during the entire taxable month, or a gas well that is incapable of producing more than 60 thousand cubic feet of gas per day.

Also exempted from the tax would be all oil or gas owned or produced by any political subdivision of this state, including that political subdivision's proprietary share of oil or gas produced under any unit, cooperative, or other pooling agreement.

No exemption is provided from payment of an ad valorem tax related to equipment, material, or other property by reason of the payment of the gross severance tax pursuant to the Act.

Reporting and Payment. Each producer would be required to prepare and file a return in the form prescribed by the BOE containing information as the BOE deems necessary or appropriate for the proper administration of the Act. The return would be due on or before the last day of the calendar month following the calendar quarter to which it relates, together with a remittance payable to the BOE for the amount of tax due.

The BOE would be authorized to prescribe those forms and reporting requirements as are necessary to implement the tax. This includes, but is not limited to, information regarding the location of the well by county, the gross amount of oil or gas produced, the price paid therefore, the prevailing market price of oil or gas, and the amount of tax due.

Any producer that fails to timely pay the tax would be required to pay interest at the rate of 1 ½ percent per month, or fraction thereof, from the date on which the tax became due and payable to and including the date of payment. The bill also specifies how payments on delinquent tax payments would be applied, which is as follows:

- First, to any interest due on the tax.
- Second, to any penalty imposed by this part.
- Third, the balance, if any, to the tax due.

Administration. The BOE would administer and collect the severance tax pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2). For purposes of the Act, the references in the Fee Collection Procedures Law to "fee" would include the tax imposed by this bill and references to "feepayer" would include a person required to pay that tax.

The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the BOE. It was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby reducing the number of sections within the bill required to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund, and appeals provisions, as well as providing the BOE the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

Other BOE Responsibilities. In addition to the collection of the severance tax, it appears that the BOE would be responsible for determining, with respect to the stripper well exemption, if the average value of oil or gas is less than three-quarters of the average gross value of the products as of the first day of the previous calendar quarter.

The BOE would also be required to monitor and, if necessary, investigate any instance where producers or purchasers of the oil or gas attempt to gouge consumers by using the tax as a pretext to materially raise the price of oil, natural gas, gasoline, diesel, or other oil or gas consumable byproducts, such as propane and heating oil. The bill specifically prohibits the severance tax from being passed through to consumers. The pass-through provisions would apply when not superseded by federal law.

Furthermore, the BOE would be required to determine the base indexes from which the rolling 30-day average daily value, as established by the market price of the product, is calculated. This average is a factor in determining the “gross value” of the oil or gas. If the oil or gas is exchanged for something other than cash, if there is no sale at the time of severance, or if the relation between the buyer and the seller is such that the consideration paid, if any, is not indicative of the true value or market price, then the BOE would determine the value of the oil or gas subject to the tax based on the cash price paid to the producer for like quality oil or gas in the vicinity of the well.

Tax Proceeds. All taxes, interest, penalties and other amounts collected, except payments of refunds and reimbursement to the BOE for expenses incurred in the administration and collection of the tax, would be deposited into the California Higher Education Fund, which this bill would create in the State Treasury. The BOE’s reimbursement for administrative expenses would be subject to appropriation by the Legislature; however, moneys in the California Higher Education Fund would be continuously appropriated to the California Higher Education Endowment Corporation. The moneys continuously appropriated would be allocated annually by the California Higher Education Endowment Corporation to the California Community Colleges, the California State University, and the University of California as prescribed in Chapter 8 (commencing with Section 99500), which this bill adds to Part 65 of Division 14 of Title 3 of the Education Code (The California Higher Education Endowment Corporation).

Definitions. This bill would include the following definitions within the Act, which pertain to the BOE:

"Gas" would mean all natural gas, including casing head gas, and all other hydrocarbons not defined as oil.

"Gross value" would mean the sale price at the mouth of the well, including any bonus, premium, or other thing of value, paid for the oil or gas, as determined by a rolling 30-day average daily value as established by the market price of the product.

"Oil" would mean petroleum, or other crude oil, condensate, casing head gasoline, or other mineral oil that is mined, produced, or withdrawn from below the surface of the soil or water in this state.

"Producer" would mean any person who takes oil or gas from the earth or water in this state in any manner; any person who owns, controls, manages, or leases any oil or gas well in the earth or water of this state; any person who produces or extracts in any manner any oil or gas by taking it from the earth or water in this state; any person who acquires the severed oil or gas from a person or agency exempt from property taxation under the United States Constitution or other laws of the United States or under the California Constitution or other laws of the State of California; and any person who owns an interest, including a royalty interest, in oil or gas or its value, whether the oil or gas is produced by the person owning the interest or by another on his, her, or its behalf by lease, contract, or other arrangement.

"Product" would mean either a barrel of oil, which means 42 United States gallons of 231 cubic inches per gallon computed at a temperature of 60 degrees Fahrenheit, or gas, as measured per 1,000 cubic feet (mfc) at a base pressure of 15.025 pounds per square inch absolute and at a temperature base of 60 degrees Fahrenheit.

"Production" would mean the total gross amount of oil or gas produced, including the gross amount attributable to a royalty or other interest.

"Severed" or "severing" would mean the extraction or withdrawing from below the surface of the earth or water of any oil or gas, regardless of whether the extraction or withdrawal shall be by natural flow, mechanical flow, forced flow, pumping, or any other means employed to get the oil or gas from below the surface of the earth or water, and shall include the extraction or withdrawal by any means whatsoever of oil or gas upon which the tax has not been paid, from any surface reservoir, natural or artificial, or from a water surface.

This bill would become effective immediately as an urgency statute; however, the Act would become operative on the first day of the first calendar quarter commencing more than six months after enactment of this bill.

BACKGROUND

Numerous legislative bills have been introduced over the last 30 years that would have imposed an oil severance assessment, tax, or fee similar to the assessment imposed by AB 656. These include AB 336 (Villaraigosa) in 1995 and AB 1693 (Margolin) in 1993. In addition, in 1992, Proposition 67, "The Economic Recovery Tax Relief Act of 1992," included, among its numerous provisions, an oil severance tax. That proposition was not approved by the voters. Most recently, a similar tax was proposed in 2006, as Proposition 87, the "Clean Alternative Energy Act," which was not approved by voters, and, in 2008, as AB 9 of the Third Extraordinary Session, which died in the Assembly Committee on Revenue and Taxation.

COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the California Faculty Association and is intended to provide a source of higher education funding to keep up with the growing demand for a skilled workforce, which the General Fund has been unable to sustain.
2. **Summary of amendments.** The **April 22, 2010, amendments** change the title of Part 21 (commencing with Section 42001) of Division 2 of the Revenue and Taxation Code from the "Oil and Gas Severance Tax Law" to the "Fair Share for Fair Tuition

Act," and make other non-substantive technical amendments to the Act. The **March 8, 2010, amendments** deleted the previous provisions that would have required the BOE to annually report to the Legislature, the Regents of the University of California, the Trustees of the California State University, and the Board of Governors of the California Community Colleges the amount of revenue that would be raised by the imposition of a 12.5 percent per barrel severance tax. The **January 14, 2010, amendments** made the Division of Oil, Gas, and Geothermal Resources in the Department of Conservation, rather than the BOE, responsible for certifying a stripper well, and revised the operative date to the first day of the first calendar quarter commencing more than six months after the bill is enacted. The **January 4, 2010, amendments** to the proposed Oil and Gas Severance Tax Law specified a tax rate of 12.5 percent of the gross product and added a definition for the term "political subdivision of the state." Other amendments to the bill are non-substantive and do not materially impact the BOE.

3. **Funding for administrative start-up costs necessary.** This bill would impose the severance tax beginning on the first day of the first calendar quarter commencing more than six months after the bill is enacted. Depending on when this measure is signed into law, the operative date of the severance tax could be January 1, 2011, or April 1, 2011. Since the BOE would begin implementing the severance tax immediately upon enactment of the bill, administrative costs would be incurred in the 2009-10 fiscal year with a January 1, 2011, operative date. And the BOE would begin to incur administrative costs in the 2010-11 fiscal year with an April 1, 2011, operative date. As such, the BOE will require an adequate appropriation to cover the BOE's administrative start-up costs not identified in the 2009-10 or 2010-11 budgets. These administrative start-up costs would include notifying producers, developing computer programs and reporting forms, and hiring appropriate staff.

4. **New BOE responsibilities outside of tax administration and collection.** This bill would require the BOE to perform duties outside its purview of tax administration, which could be problematic since such responsibilities are out of the BOE's area of expertise. These duties, in part, are as follows:

   - **Consumer Pass-Through Prohibition.** This bill provides that the severance tax cannot be passed through to consumers by way of higher prices for oil, natural gas, gasoline, diesel, or other oil or gas consumable byproducts. The BOE would be required to monitor and, if necessary, investigate attempts to "gouge consumers by using the tax as a pretext to materially raise the price" of oil, gasoline, or diesel fuel, or other oil or gas consumable byproducts. It is unclear how the BOE would enforce such a pass-through prohibition. How would the BOE know what portion of a price increase on oil and gas is due to the imposition of the severance tax, as opposed to other costs of production and market fluctuations?

     Additionally, there is no specific penalty for violating the anti-pass-through provision.

   - **Gross Value.** The bill defines gross value to mean the sale price at the mouth of the well, including any bonus, premium, or other thing of value, paid for the oil or gas, as determined by a rolling 30-day average daily value as established by the market price of the product. The BOE would be required to determine the base indexes from which the average is calculated. How exactly would this work? BOE staff is concerned with providing taxpayers with timely "gross value" information so that the proper amount of tax is imposed and reported by the producer. It appears that this bill would require the BOE to determine each day the gross value based on a rolling 30-day average. To provide this information timely, the BOE would have to compute and then publish daily the gross value on our web site. Imposing the proposed tax on a gross value amount that changes daily would complicate reporting and likely result in reporting errors, thus requiring additional BOE resources for audit and compliance functions.

Furthermore, it should also be noted that each product (e.g. natural gas, casing head gas, crude oil, etc) will have a different price, which would require the BOE to calculate a daily value for multiple products.

- **Stripper Well Certification.** This measure was amended to require the Department of Conservation's Division of Oil, Gas, and Geothermal Resources to certify stripper wells. The author may also wish to consider amending the bill to require them to notify the BOE of its findings. In addition, the bill should clarify whether the average value of oil or gas to be determined is the oil or gas specific to that stripper well, or the per-barrel or per cubic feet price of California oil or gas in general and, if the former, the method of determining the average value of stripper well oil or gas. Is there a reliable source for this information?

5. **Would the tax apply to oil or gas acquired from a political subdivision?** Section 42016 states that the assessment does not apply to "oil or gas owned or produced by any political subdivision of this state, including that political subdivision's proprietary share of oil or gas produced under any unit, cooperative, or other pooling agreement." This bill defines the term "political subdivision of the state" to include any local public entity, as defined in Section 900.4 of the Government Code ("Local public entity" includes a county, city, district, public authority, public agency, and any other political subdivision or public corporation in the State, but does not include the State). This exemption seems to imply that oil or gas produced by any political subdivision, as defined, would be permanently exempt from the tax as the oil or gas changes ownership.

   However, Section 42002(e) includes as a producer any person who acquires the severed oil or gas from a person or agency exempt from property taxation under the United States Constitution or other laws of the United States or under the California Constitution or laws of the State of California. The severance tax is imposed upon all producers at the rate of 12.5 percent of the gross value of each barrel of oil or gas severed. Since land owned by the political subdivision, as defined, is exempt from property tax, is this measure intended to impose the severance tax upon any person that acquires the severed oil or gas from the political subdivision as a "producer?"

   This measure should clarify whether the definition of "producer" would apply in this situation or whether oil or gas severed from these lands would be permanently exempt from the severance tax as it changes ownership.

6. **Property Tax Exemptions.** Although the definition of "producer" references persons or agencies exempt from property tax, an exemption from property tax applies to the property itself, not to the persons or entities that own the property. Presumably, this provision means that if the oil or gas is severed from land exempt

from property tax based on ownership, then the first purchaser would pay the assessment. Property exempt from property tax includes property owned by the federal government or a federal instrumentality, property owned by the state, and property owned by a local government which is located within its boundaries. (If the property is located outside its boundaries, then the property is taxable pursuant to Article XIII, Section 11, if it was taxable when acquired by the local government.)

The following table summarizes the possible assessment treatment of oil or gas severed from land under different ownership as well as the person responsible for the assessment.

Oil Land Ownership	Land Exempt From Property Tax	Who Pays Tax
Private Lands	No	Producer
Federal Lands	Yes	First Purchaser
State Lands	Yes	Requires Clarification As Noted in Comment #5
Political Subdivisions of the State (County, City, Other)	Yes	Requires Clarification As Noted in Comment #5
State Offshore (Coast to 3 nautical miles)	Yes	Requires Clarification As Noted in Comment #5
Federal Offshore (Between 3 and 12 nautical miles)	Not Subject To Property Tax	Not Subject To Tax
Outside 12 nautical miles	Not Subject To Property Tax	Not Subject To Tax

7. **How would the severance tax be imposed on and reported by a person who owns an interest, including a royalty interest, in oil or gas but does not produce the oil or gas?** This bill defines “producer” to include “any person that owns an interest, including a royalty interest, in oil or gas or its value, whether the oil or gas is produced by the person owning the interest or by another on the person’s behalf by lease, contract, or other arrangement.” Further, this bill imposes the oil and gas severance tax “on any producer” at a rate of 12.5 percent of the gross value of the product and requires that each producer prepare and file a return with the BOE and pay the tax imposed quarterly. Is there a possibility that, if the person who owns the interest does **not** produce the oil or gas him or herself, the tax may be paid both by this producer **and** by the producer who does produce the oil or gas? In other words, could the tax be paid twice (or more, if there is more than one person who owns an interest) on the same oil or gas? In addition, is there a means by which a person who owns an interest but does not produce the oil or gas would have access to the gross amount produced, price paid, market price, and other data that would enable that person to accurately calculate, report, and pay the tax due?

   If these concerns are valid, the author may want to amend the definition of “producer” and/or otherwise amend the bill to address them.

8. **Interest and application of delinquent payments.** This bill requires any person that fails to pay any tax within the time required to pay interest at the rate of 1 ½ percent per month, or fraction thereof, from the date on which the tax became due and payable to and including the date of payment. The Fee Collection Procedures Law, under which the severance tax would be administered and collected by the BOE, imposes interest at the modified adjusted rate per month, or fraction thereof, established pursuant to Revenue and Taxation Code Section 6591.5. For the 2010 calendar year, the rate is set at 7 percent for deficiencies.

   Due to the conflicting interest rate provisions, it is suggested amending the bill to make it clear that the interest provisions set forth in Section 42010(a) prevail. The following language is suggested:

   > 42010. (a) <u>Notwithstanding Revenue and Taxation Code Sections 55041, 55042, 55050, and 55061, any</u>~~Any~~ person that fails to pay any tax within the time required shall pay, in addition to the amount of tax owed, interest at the rate of 1 ½ percent per month, or fraction thereof, from the date on which the tax became due and payable to and including the date of payment.

   The bill also specifies that the application of delinquent severance tax payments first be applied to the interest due on the tax and second to any penalty imposed. Only then would remaining amounts of the payment be applied to the balance of the tax itself. Currently, BOE-administered programs that apply delinquent payments in this order include the insurance tax and motor vehicle fuel tax (both collected by the Controller). In all the other tax and fee programs administered by the BOE, the application of payments to delinquent tax liabilities is uniform: payments are applied first against the tax, then against penalties, and lastly against interest.

   It should be noted that applying delinquent severance tax payments in the order proposed by this bill would <u>not</u> reduce the tax liability where partial payments only cover interest and penalty amounts. Under such circumstances, interest would continue to accrue on the full amount of tax due to which future payments would again first be applied, thus making it difficult for taxpayers to reduce their tax liability.

9. **Suggested technical amendments.** In order to avoid any ambiguity with the administration of the proposed tax, the author may wish to amend the bill to address the following concerns:

   - **Tax Imposition.** This bill would apply the severance tax <u>equally to all portions</u> of the gross value of each barrel of oil or gas severed. It is unclear why the imposition of the tax includes the language that it applies “equally to all portions.” Is the “equally to all portions” language necessary?
   - **Definitions.** "Gross value" is defined to mean the sales price of the barrel of oil or gas at the mouth of the well. The bill does not contain a definition for the term “mouth of the well.” To avoid any ambiguity as to what constitutes a “mouth of the well,” it is suggested the bill be amended to define this term.
   - **Regulations.** This bill should authorize the BOE to prescribe, adopt, and enforce rules and regulations relating to the administration and collection of the Act. In addition, the bill should also include authorization for the BOE to adopt emergency regulations as necessary to implement the proposed severance tax program.

In addition, the following amendments are suggested:

> 42002.(h) "Product" means either a barrel of oil, which means 42 United States gallons of 231 cubic inches per gallon computed at a temperature of 60 degrees Fahrenheit, or gas, as measured per 1,000 cubic feet (mfc) at a base pressure of 15.025 pounds per square inch absolute and at a temperature base of 60 degrees Fahrenheit.
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> 42012. The tax imposed by this part shall be in addition to any other tax that may be imposed with respect to the severing of oil or gas or transactions related thereto, including, without limitation, any ad valorem taxes imposed by the state, or any political subdivision of the state, or any local business license taxes that may be incurred ~~as a~~ for the privilege of severing oil or gas from the earth or water or doing business in that locality. There shall be no exemption from payment of an ad valorem tax related to equipment, material, or property by reason of the payment of the ~~gross~~ severance tax pursuant to this part.
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> 42145. The board shall administer and collect the tax imposed by this part pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2). For purposes of this part, the references in the Fee Collection Procedures Law to "fee" shall include the tax imposed by this part and to "feepayer" shall include a ~~person~~ producer required to pay the tax imposed by this part.

10. **Related legislation.** AB 1604 (Nava) would also impose an oil severance tax but the proceeds would be deposited into the General Fund. The bill is in the Assembly Revenue and Taxation Committee.

COST ESTIMATE

The collection of this severance tax would result in the BOE incurring potentially significant costs related to the administration and collection of the assessment proposed by this bill. These costs would be related to notifying taxpayers, developing returns, programming computers, developing and carrying out compliance and audit efforts to ensure proper reporting, and administering the assessment. In addition, there would be significant costs involved in hiring and training BOE employees to carry out those responsibilities outside the BOE's traditional tax collection and administration responsibilities. These estimated costs are pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The California Department of Conservation (DOC) maintains detailed data summarizing oil and natural gas production throughout the state.

- ***Oil Production.*** DOC data indicate that oil production subject to this bill totaled roughly 218 million barrels in 2007. Oil production in the state has declined since 1992 at an average annual rate of 2.2 percent per year. This estimate assumes that this rate of decline will continue through 2012-13.
- ***Price of Oil.*** West Texas Intermediate (WTI) oil is a type of crude oil used as a benchmark in oil pricing. Over the past nine years, California crude has sold for an average of $9 per barrel less than WTI. This revenue estimate is based on a forecast of WTI from a national macroeconomic forecasting firm that assumes that oil prices will rise through 2013 as the economy recovers from the current recession. Using the historical relationship between the price of WTI and the price of California crude, we assume that the per-barrel price of California crude will average $70 in 2010-11, $78 in 2011-12, and $82 in 2012-13. This measure includes a provision that oil produced by a stripper well would be exempt from the tax if the price of oil is less than 75 percent of what it was on January 1st of the prior year. Because we assume that oil prices will rise gradually but consistently through 2013, it is assumed that the output from stripper wells will be subject to the tax.
- ***Natural Gas Production.*** DOC data indicate that natural gas production subject to this bill has increased since 1993 at an average rate of 0.2 percent per year. This estimate assumes that this slight rate of increase will continue through 2012-13.
- ***Price of Natural Gas.*** We do not have access to a forecast of natural gas prices. Instead, this estimate assumes that the price of natural gas will rise through 2013, following a pattern similar to that of WTI.

REVENUE SUMMARY

Based on our assumptions, the revenue impact of imposing a 12.5 percent oil and natural gas severance tax would be $526 million in 2010-11, $2.3 billion in 2011-12, and $2.4 billion in 2012-13 detailed as follows:

Figure 1: Summary of Revenue Estimate for AB 656
Dollars in Millions

	2010-11	2011-12	2012-13
Oil Production	$443	$1,925	$1,982
Natural Gas Production	83	364	382
Total	$526	$2,289	$2,364

Qualifying Remarks. A key assumption underlying this revenue estimate is the forecasted price of oil, whose price can be quite volatile. As national macroeconomic forecasts periodically get updated to reflect new employment, output, and other key data, the forecasted price of oil can change significantly, which in turn would impact the revenues raised by this measure. As an order of magnitude, if the price of oil averages $5 more/less per barrel in 2011-12 than we assume, the resulting revenues would be $100 million higher/lower.

Reduction in Local Property Tax Revenues. Local property tax revenue derived from oil and gas reserves would decline under the measure relative to what they otherwise would have been, to the extent that the imposition of the severance tax reduces the value of oil reserves in the ground and its assessed property value for tax purposes. The exact size of this impact is unknown, as it would depend on future oil prices.

Reduction in State Income/Corporation Tax Revenues. Oil and gas producers would be able to deduct the severance tax from earned income, thereby reducing their state income tax/corporation tax liability. The extent to which the measure would reduce state taxes paid by producers is also unknown, and would depend on various factors, including whether or not a producer has taxable income in any given year and the amount of such income that is apportioned to California.

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