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November 4, 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 and education funding (A.G. File No. 11-0044).

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 15 percent "severance 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 wells capable of producing less than ten barrels per day of oil or 60,000 cubic feet of gas per day would be exempt when the value of a barrel of oil or gas from those wells was $50 or lower. The measure states that the costs of the tax may not be passed on to 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:

- 38 percent to the state's California Community College (CCC) system, to be allocated at the discretion of the system's Chancellor.
- 37 percent to K-12 school districts to be allocated at the discretion of the state's Superintendent of Public Instruction.
- 14 percent to the California State University (CSU) system, to be allocated at the discretion of the CSU Board of Trustees.

- 11 percent to the University of California (UC) system, to be allocated at the discretion of the UC Board of Regents.

The revenues could be used in K-12 education only to reduce class sizes, hire teachers, or provide instructional materials. The revenues could be used in higher education only to reduce tuition fees, restore class sections that had been cut, or hire needed professors. The measure declares that the revenues dedicated to education activities must supplement and, therefore, not supplant existing levels of state funding.

Fiscal Effects

New Revenues. The 15 percent severance tax would likely generate around $3 billion annually in its first years. A wide range of revenues, however, is possible 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, and CCC, CSU, and UC systems. While the measure states that severance tax revenues may not supplant existing levels of state funding, it is unclear how such a provision could be enforced, especially for higher education.

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.

Summary of Fiscal Effect

This measure would have the following major fiscal effect:

- Increased state revenues from a new oil and gas severance tax of around $3 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