San Diego County Taxpayers Association

Taxpayers watchdog since 1945

707 Broadway, Suite 905, San Diego, CA 92101
P: (619) 234-6423 • F: (619) 234-7403 • www.sdcta.org

Proposition 39: The California Clean Energy Jobs Act

SDCTA **OPPOSES** Proposition 39. Proposition 39 would significantly change California's method of corporate taxation. In 2011, California began giving companies an option to choose between a single sales factor and three factor apportionment formula. The apportionment formula is used to determine the business presence of a multistate corporation within any given state for tax purposes. It is too early to know the results of giving companies an option and changing the corporation taxation method again would create further uncertainty. Changes to corporate taxation policy should be rare to allow for businesses to make long-term decisions. New revenues from the measure would be used to fund renewable energy projects throughout California. These types of budgeting decisions should be made in the budgeting process allowing legislators to carefully weigh the importance of competing programs.

- In 2011, California changed corporate tax law to allow companies to choose between two options for determining the business presence of a multistate corporation within California for tax purposes:
    - The ***three factor formula*** apportionment method weights sales within the state twice as much as the amount of property and payroll within the state.
    - The ***single sales factor*** apportionment method places all of the weight on the amount of sales within the state, and does not consider property or payroll.

- Prop 39 would alter California's corporate income tax code to require multistate companies in California to use a single sales factor apportionment formula.

- The single sales factor mandate would raise net corporate income tax revenues an estimated $1.1 billion in fiscal year 2013-2014 and increase annually.

- Up to $550 million of new tax revenues would be dedicated to clean energy job creation every fiscal year from 2013-2014 to 2017-2018. Dedicating these funds to renewable energy projects means they are not dedicated to healthcare, education, or reducing the deficit.

- Changing corporate income taxation again only one year after reform would create further uncertainty for California businesses.

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Proposition 39 – The California Clean Energy Jobs Act

August 2012

Board Action: **OPPOSE**

Title: *"The California Clean Energy Jobs Act"*
Description: Tax Treatment for Multistate Businesses. Clean Energy and Energy Efficiency Funding.
Jurisdiction: State
Type: Initiative Statute
Vote: Simple Majority
Fiscal Impact: $1.1 billion in new tax revenues in 2013-2014 and growing each year

Rationale

Proposition 39 would significantly change California's method of corporate taxation. In 2011, California began giving companies an option to choose between a single sales factor and three factor apportionment formula. The apportionment formula is used to determine the business presence of a multistate corporation within any given state for tax purposes. It is too early to know the results of giving companies an option and changing the corporation taxation method again would create further uncertainty. Changes to corporate taxation policy should be rare to allow for businesses to make long-term decisions. New revenues from the measure would be used to fund renewable energy projects throughout California. These types of budgeting decisions should be made in the budgeting process allowing legislators to carefully weigh the importance of competing programs.

Background

Corporate Income Tax Apportionment

In 1957, the National Conference of Commissioners on Uniform State Laws crafted the Uniform Division of Income for Tax Purposes Act (UDITPA) which was adopted by California in 1966.[1] The Act created a three factor corporate income tax apportionment method that was used by most states for several decades. The three factors considered when determining how much of a multistate corporation's business is within California for tax purposes are sales, property, and payroll. California changed its apportionment formula to a different three factor formula in 1993. Also known as the "Double-Weighted Sales Factor," the weight placed on sales is double that of the weight placed on payroll and property.[2] To ensure fair taxation, UDITPA also requires states to assess corporate taxes based on the percentage of a firm's sales within that state. For example, if a

[1] "Corporate Income Tax Apportionment and the 'Single Sales Factor'". Institute on Taxation and Economic Policy. August 2011.

[2] Taylor, Mac. "Reconsidering the Optional Single Sales Factor." Legislative Analyst's Office. May 2010. Page 5.

firm makes ten percent of its profits in California, then California can only tax ten percent of that firm's taxable income.[3]

The following table highlights the disparities in corporate taxation depending on the location of property, personnel, and sales:

Table 1: Hypothetical Businesses using Three Factor Formula[4]
Current Option and Only Option from 1993 to 2011

	Proportion of Business Activity in State		Formula Applied	
	Firm A	**Firm B**	**Firm A**	**Firm B**
Sales	50%	10%	50% x ½ = 25%	10% x ½ = 5%
Property	10%	40%	10% x ¼ = 2.5%	40% x ¼ = 10%
Payroll	10%	40%	10% x ¼ = 2.5%	40% x ¼ = 10%
Percent of total business income taxed by California			**30%**	**25%**

Firm A makes half of all sales in California and has a small fraction of business operations (property and payroll) in the state. Firm B has a larger property and payroll presence but a small fraction of sales in California. Table 1 shows the difference in apportionment for each firm when a three-factor formula is applied.

Single Sales Factor
A single sales factor apportions corporate taxes on only sales ignoring the location of payroll and property. Table 2 shows the same hypothetical firms under a single sales factor apportionment formula:

Table 2: Hypothetical Businesses using Single Sales Factor[5]
Currently One Option (Since 2011)

	Proportion of Business Activity in State		Formula Applied	
	Firm A	**Firm B**	**Firm A**	**Firm B**
Sales	50%	10%	50% x 1 = 50%	10% x 1 = 10%
Property	10%	40%	10% x 0 = 0%	40% x 0 = 0%
Payroll	10%	40%	10% x 0 = 0%	40% x 0 = 0%
Percent of total business income taxed by California			**50%**	**10%**

States change the apportionment formula, weighing sales more heavily, in order to remove disincentives to locate within their state. Placing less weight on payroll and property makes states

[3] "Corporate Income Tax Apportionment and the 'Single Sales Factor'". Institute on Taxation and Economic Policy. August 2011.
[4] "Senate Bill 79/Assembly Bill 103." San Diego County Taxpayers Association. April 2011.
[5] *Ibid*.

more attractive to investors regardless of where most sales happen. Recently, states have decreased the property and payroll factors to compete for manufacturing jobs.

Recent History
In 2011, Senate Bill 79/Assembly Bill 103 contained language mandating a single-sales factor, but that language was removed before passage. It would have amended the state's corporate tax law to require that all businesses operating within and outside California use a single sales factor formula in assessing taxable income. SDCTA opposed SB79/AB103 because the benefits of converting to a mandatory single sales factor apportionment formula were not well-established. There is evidence that a single-sales formula might benefit the State in terms of job retention; however, switching to a single sales formula may provide incentives for many corporations to restructure their operations in California to avoid future tax liability.

Proposal

Proposition 39 is a statewide initiative that received the required number of signatures to appear on the November 2012 ballot. It would increase tax revenues using the same method attempted in SB 79/AB 103. There are still significant concerns about its effects on corporate investment in California. The proposition would result in a net tax revenue increase. Proposition 39 seeks to raise revenues by requiring firms to use the single sales factor when determining the portion of their business that is within California for tax purposes, and use approximately half of the new revenues to fund clean energy projects throughout the state.

If passed, Proposition 39 would:

- Require multistate businesses operating in California to calculate state corporate income taxes using a single-sales factor apportionment formula (businesses can currently elect a single sales factor or three-factor formula every fiscal year);
- Use $550 million of estimated tax revenue increases from the single sales factor mandate and use the funds to finance renewable energy projects statewide.

The Clean Energy Job Creation Fund
The increased tax revenues under Proposition 39 will go toward funding clean energy projects statewide. The Legislative Analyst's Office predicts an extra $1.1 billion in tax revenue per year, $550 million of which will be transferred from the General Fund to the newly created Clean Energy Job Creation Fund. If new revenues are below $1.1 billion then 50% of the amount will be set aside for the Fund. Transfers will continue every fiscal year from 2013-2014 through 2017-2018.[6]

Proposition 39 grants state and local government agencies with experience in energy project management the power to select which projects receive financing from the Fund. However, all projects will be coordinated with the California Energy Commission and the California Public Utilities Commission. Project selection will be based on maximization of job creation and energy benefits.

[6] "The California Clean Energy Jobs Act." Retrieved from <http://ag.ca.gov/cms_attachments/initiatives/pdfs/i1024_11-0080_%28clean_energy_jobs%29.pdf>. Accessed July 18 2012. Page 2.

The authors of Proposition 39 claim that the increased tax revenue will create 40,000 new jobs in California.[7]

Renewable Energy Project Selection and Oversight
According to the Legislative Analyst's Office (LAO), the Legislature would be tasked with determining spending from the newly created fund, and would be required to only pursue programs that are cost-effective over the long term.

Energy efficiency projects at the following locations qualify for financing from the Clean Energy Job Creation Fund:[8]

1) Public schools
2) Universities and Colleges
3) Other public buildings
4) Job training and workforce development (California Conservation Corps, YouthBuild, and other workforce development programs that provide energy efficiency training)
5) Public-private partnerships

The initiative states that existing government agencies, such as the California Public Utilities Commission (CPUC) and the California Energy Commission (CEC), and local governments, would select and oversee the projects. Additionally, new Citizens Oversight Board would be created to annually review all fund expenditures and report to the Legislature. The oversight board would consist of nine members appointed by the State Treasurer, the State Controller, and the Attorney General.

Fiscal Impact
The following table shows estimated effects of the mandatory single sales factor:

Table 3: Estimated Effects of Prop 39[9]

	2012-2013	2013-2014 through 2017-2018	2018-2019 and beyond
Annual Revenues	$500 million	$1 billion and growing	Over $1 billion
Amount dedicated to energy projects	None	$500 to $550 million	None
Increase in school funding guarantee	$200 to $500 million	$200 to $500 million	$500 million to $1 billion

Source: Legislative Analyst's Office

[7] *Ibid* at 1.
[8] *Ibid*
[9] "Proposition 39: Tax Treatment for Multistate Businesses. Clean Energy and Energy Efficiency Funding. Initiative Statute." Legislative Analyst's Office. 18 July 2012. Page 4.

The estimated increased revenues are split between undedicated state revenues, the newly created Clean Energy Job Creation Fund, and revenues directed toward schools in accordance with Proposition 98. The LAO does not address fiscal impacts related to administration costs as administrative structures are already in place and any costs associated with administration are expected to be relatively insignificant. The initiative states that existing government agencies would select and oversee the projects. The programs that are expected to be impacted, such as appliance rebate programs and public facilities investment programs would likely see increased funding.

Policy Discussion

Raising Taxes

Proposition 39 raises tax revenues by increasing the tax burden on some firms but not others. California-based companies that do a majority of sales in other states would see tax savings, while out-of-state companies that do significant sales in California would likely see a tax increase. The result is a less fair corporate tax system. Under a single sales factor, a corporation with all its employees and property in California that makes its sales in other states will not have to pay any California corporate income tax. This could result in successful California-based companies being exempt from income taxes while companies that make significant profits within the state will see a tax increase.[10] This perverse incentive could cause investors to avoid investing in California and give California-based companies who make significant sales within California reason to relocate to other states.

Ballot Box Budgeting

As mentioned in the Fiscal Impact section of this report, the estimated increased revenues are split between undedicated state revenues, the newly created Clean Energy Job Creation Fund, and revenues directed to schools in accordance with Proposition 98.

When initiatives require specific budgeting decisions, they limit the ability of legislators to carefully weigh the importance of competing programs during the budgeting process. Dedicating funds to renewable energy projects means they are not dedicated to healthcare, education, or reducing the deficit.

Job Creation

The authors of Proposition 39 claim that the Clean Energy Job Creation Fund will create 40,000 new jobs in California.[11] However, that number is suspect because the scale of the projects that will receive funding is currently unknown and will not be known until after the Fund is created. Furthermore, it is unclear how many jobs would be lost due to tax increases.

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[10] "Corporate Income Tax Apportionment and the 'Single Sales Factor'". Institute on Taxation and Economic Policy. August 2011.

[11] "The California Clean Energy Jobs Act." Retrieved from <http://ag.ca.gov/cms_attachments/initiatives/pdfs/i1024_11-0080_%28clean_energy_jobs%29.pdf>. Accessed July 18 2012. Page 1.

Assembly Bill 1500

The State Assembly voted to pass Assembly Bill (AB) 1500 on August 13, 2012. AB 1500 would make identical changes to the California corporate income tax code and mandate the single sales factor apportionment method. However, AB 1500 places revenues in a newly created Middle Class Scholarship Fund. The Fund would serve the following purposes:

- Decrease University of California and California State University tuition fees by two-thirds for students whose families earn less than $150,000 per year
- Reserve $150 million to provide financial assistance to community college students

If AB 1500 survives the Senate and is signed into law by Governor Brown, Proposition 39 will still appear on the November 2012 ballot. However, supporters of Proposition 39 have agreed to stop campaigning for the California Clean Energy Jobs Act if AB 1500 becomes law. Under AB 1500, the Department of Finance will deposit an amount equal to the preliminary estimated increase in revenues attributable to the single sales factor mandate every fiscal year. By Senate rules, AB 1500 cannot be adopted after August 31, 2012.

Supporters of Proposition 39

- Hedge fund manager Thomas Steyer is the primary financial backer of Proposition 39.
- Californians for Clean Energy Jobs is the secondary financial backer.
- The California Legislative Analyst's Office writes favorably about mandatory use of a single sales factor, but it is unknown if LAO supports the creation of the Clean Energy Job Creation Fund.

Opponents of Proposition 39

- Coalition of businesses California Employers Against Higher Taxes. The coalition spokesman Peter DeMarco has said that the ballot measure will drive jobs out of California. The coalition includes:
  - Chrysler,
  - General Motors,
  - Kimberly-Clark and
  - International Paper