Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 590 (Senator Frosh, *et al.*)
Budget and Taxation

Windfall Oil Profits Tax - Energy-Saving Investment Program

This bill imposes a windfall profit tax on integrated oil companies or any corporation that is engaged in the business of producing, refining, distributing, or marketing petroleum products. Any revenue generated is to fund an energy-saving investment program created by the bill and administered by the Maryland Energy Administration. MEA and the Comptroller's Office are required to adopt regulations to implement the bill.

The bill takes effect July 1, 2006 and applies to tax year 2006 through 2015. The bill terminates June 30, 2016.

Fiscal Summary

State Effect: Potential significant increase in special fund revenues in FY 2008 and beyond due to imposition of the windfall profit tax. Corresponding increase in special fund expenditures at MEA in FY 2008 and beyond for energy-saving investment programs. General fund expenditures would increase by approximately $338,400 in FY 2008 due to implementation costs at the Comptroller's Office.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
SF Revenue	$0	-	-	-	-
GF Expenditure	0	338,400	256,200	270,500	285,900
SF Expenditure	0	-	-	-	-
Net Effect	$0	($338,400)	($256,200)	($270,500)	($285,900)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful. This bill could result in a significant increase in fuel prices for small businesses.

Analysis

Bill Summary: This bill imposes a windfall profit tax on "integrated oil companies" in addition to any State income tax imposed. The tax rate is 50% of a specified corporation's "windfall profits," as calculated by the bill. The bill defines an integrated oil company as: (1) a corporation that is engaged in the business of producing, refining, distributing, or marketing petroleum products; or (2) an affiliated group of corporations that is engaged in the businesses listed previously and more than 50% of the voting stock of each member is owned by either a common owner or owners or one or more member corporations of the group.

Windfall profits are the amount of a corporation's unitary income for the current tax year in excess of the corporation's adjusted base year unitary income. Unitary income is the combined income allocated to Maryland of all the members of an affiliated group of corporations that are an integrated oil company. The adjusted base year unitary income is the unitary income of a corporation for the base year increased by 110% times the percentage change in the total Maryland taxable income for all corporations for the most recent tax year for which data is available over the total Maryland taxable income for all corporations for the base year. The base year is 2004 or another tax year that the Comptroller's Office allows.

The bill creates an energy-saving investment program consisting of energy-efficiency programs. The bill also creates an energy savings investment fund for the purpose of saving energy, reducing consumer energy costs, and reducing pollution. The fund is to receive revenues generated from the windfall profits tax and any other appropriated funds. A maximum of 10% of the fund can be expended by MEA for administrative costs. MEA is required to prepare and maintain an energy-saving investment plan, which is required to be submitted to the Governor and the General Assembly by December 31, 2007; with an updated version by December 1, 2009. The plan is required to describe, evaluate, and recommend energy efficiency programs that are designed to:

- "transform markets," so that energy-efficient products and services become more broadly available;
- capture opportunities for cost-effective energy efficient designs, materials, and equipment related to housing and buildings;
- reduce peak electricity demand and increase service reliability;

- reduce natural gas peak demand and price volatility;
- ensure participation in energy saving programs by low-income individuals; and
- encourage the development of commercially viable State energy resources.

The plan submitted by MEA must contain: (1) current information on energy sales and consumption and current practices in the marketplace that influence energy consumption; (2) recommendations on which energy efficient programs should be implemented; (3) goals and budgets for energy efficiency programs recommended for implementation; (4) procedures for gathering information on the effects of each recommended energy efficiency program; (5) an evaluation of each program's effectiveness; (6) recommendations, if any, of the energy-saving investment board created by the bill; (7) a list of energy efficiency programs undertaken independently by an electric or gas company; and (8) a demonstration that any recommended program does not contradict or duplicate any existing residential energy efficiency programs. Any plan must: (1) provide that energy efficiency programs are offered statewide to residential retail gas and electric customers; (2) yield net savings of energy and be found to be cost effective; and (3) have at least 25% of its funds directed towards programs serving low-income gas and electric customers.

In addition, MEA is required to administer and assess the energy efficiency programs and adopt regulations to implement the program. By October 1, 2006, the MEA director is required to convene an energy-saving investment advisory board, which includes representatives of the Office of People's Counsel; Public Service Commission; participating gas and electric companies; the State agency that administers a weatherization program for low-income individuals; and nonprofit organizations concerned with energy and environmental policy or that serve low-income individuals. The purpose of the board is to provide recommendations on programs implemented by the bill.

Beginning on March 30, 2008, MEA in cooperation with the Comptroller's Office is required to submit an annual report on the fund to the General Assembly.

Current Law: There is no windfall profit tax on integrated oil companies or any corporation that is engaged in the business of producing, refining, distributing, or marketing petroleum products. The income of these corporations attributable to Maryland is subject to the State's corporate income tax.

Background: The consumption of gasoline in Maryland involves a five-step process.

1. Crude oil is extracted from petroleum traps in the ground.
2. Crude oil is shipped via barge, ship, and pipeline to refiners.

3. Refiners process the crude oil into a variety of products, including gasoline, and transfer it via ship, pipeline, barge, or truck to distribution terminals (also known as the rack).
4. Once it reaches the terminals, the gasoline is either shipped directly to retail service stations (also known as retailers) by an integrated refinery system, or sold to wholesalers (also known as "jobbers").
5. Jobbers sell or distribute gasoline to retailers.

Maryland is not an oil-producing State. In addition, there are no refineries in Maryland, which relies heavily on Gulf Coast refineries. A refiner can sell gas through a direct, integrated distribution system (the refiner sells to retail service station that sells a branded product, such as Exxon, BP, etc.). On average, gasoline retailers sell 8 million gallons of gasoline daily, in addition to 1.5 million gallons of diesel. As of September 2005, there are 2,077 retail service stations in Maryland. Of those, 695 or approximately one-third are unbranded gasoline stations.

Branded stations in Maryland may be (1) company owned, but operated by independent lessee-dealers; or (2) retail outlets owned and operated by independent open dealers, who agree to sell only branded product. Maryland's divorcement law prohibits refiners from owning and operating a retail service station. Exxon/Mobil, Shell, Citgo and BP/Amoco have the largest branded gasoline presence in the State, with approximately 20%, 15%, 13%, and 10% of all Maryland retail stations respectively.

Unbranded stations, such as Wawa or Costco, are not affiliated with a particular brand, but purchase from a variety of oil companies. Generally, unbranded stations purchase the majority of their product on the spot market, either directly from refiners or from wholesalers, and typically only contract a small portion for a long-term supply. Approximately 50% of the gasoline sold by an oil company may end up being sold to unbranded stations. Data on the number of unbranded stations operating under a common name were available for all these stations except Crown. Crown stations comprise approximately 4% of all retail gasoline stations. Approximately 54% of unbranded gasoline stations are one-station operations. The other stations are under a common name that operates more than one station. Thirteen percent of unbranded stations are under a common trade name that operates 2 to 5 stations, 8% have 6 to 10 stations, and 25% have more than 11 stations.

Alternatively, a refiner can sell gasoline through a wholesale "jobber" distribution network. The jobber, or middleman, buys gasoline at the terminal rack price and then delivers the gasoline to (1) stations it owns or operates; (2) stations it owns and leases to third parties; or (3) stations that are independently owned and operated. On the East Coast, most of the gasoline is distributed through jobbers.

State Revenues: The bill imposes a windfall profit tax on integrated oil companies or any corporation that is engaged in the business of producing, refining, distributing, or marketing petroleum products beginning in tax year 2006.

Corporations can file using a calendar tax year or a fiscal tax year. Many corporations utilize an automatic six-month extension, delaying the calculation of windfall profits for corporations affected by the bill until September 15, 2007. Based on this information, the Comptroller's Office advises that tax year 2007 is the earliest tax year that the windfall tax could be calculated and imposed.

Special fund revenues could increase significantly in fiscal 2008 and beyond due to the imposition of the tax. The amount of increase depends on the amount of Maryland income reported by all corporations and by corporations subject to the windfall tax and cannot be reliably estimated at the time.

State Expenditures: Expenditures could increase at the Comptroller's Office and the Maryland Energy Administration due to the implementation of Energy-Saving Investment Programs.

Comptroller's Office

General fund expenditures could increase by approximately $338,400 in fiscal 2008, which reflects an implementation date of tax year 2007. This estimate reflects the cost of hiring four new auditors to calculate unitary incomes and audit affected corporations and includes costs for data processing changes to the SMART income tax return processing and imaging systems, and systems testing. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	4
Salaries and Fringe Benefits	$222,023
Equipment/Operating Expenses	32,186
Computer Programming Expenses	84,150
Total FY 2008 Comptroller Expenditures	**$338,359**

Future year expenditures reflect: (1) 4.6% annual increases in salaries and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Energy-Saving Investment Program

The bill provides that any revenue generated from the windfall profit tax be credited to the energy savings investment fund. The amount of expenditures would depend on the revenue generated from the windfall profit tax and cannot be reliably estimated. The bill provides that up to 10% of the funds credited to the energy savings investment fund can be used for administration costs at MEA. It is assumed that this amount would be sufficient for administration costs at MEA.

Small Business Effect: Small businesses do not typically file a corporate income tax return. However, to the extent that any small business that is a jobber or retail service station files a corporate income tax return, these small businesses would be negatively impacted by the bill. In addition, the incidence of the tax would partly be borne by the corporations paying the tax and partly paid by consumers of petroleum products. Small businesses would be negatively impacted due to the increase in fuel prices that would likely by caused by the bill.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - March 12, 2006
ncs/hlb

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