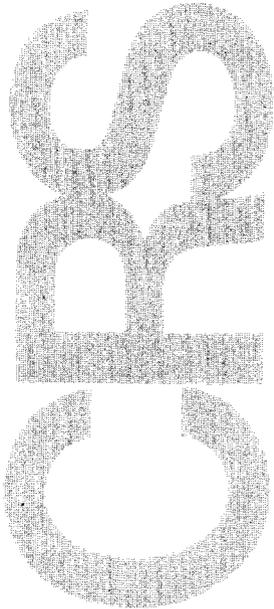


THE CRUDE OIL WINDFALL PROFIT TAX ACT: CONTEXT AND CONTENT

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ABSTRACT

Debate over natural gas pricing has included the consideration of a windfall profit tax, with the oil windfall profit tax as a possible guide to what might be levied on natural gas at the wellhead. This report reviews the issues surrounding the enactment of the crude oil windfall profit tax, spells out its provisions, and provides data on the revenues collected and anticipated.

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THE CRUDE OIL WINDFALL PROFIT TAX ACT: CONTEXT AND CONTENT

I. INTRODUCTION

A. Background

In an attempt to reverse the Nation's growing use of foreign petroleum, President Carter in June 1979 began a gradual process of removing domestic petroleum price controls that had existed in some form since August 1971. Despite the steep world oil price increases and supply interruptions during the middle and late Seventies, U.S. consumption of petroleum continued to increase, and the proportion of oil consumed that came from abroad persisted above 40 percent. It was expected that higher prices for domestic oil would encourage domestic production and discourage consumption of petroleum, thus reducing imports. President Reagan removed price controls completely on January 28, 1981.

With the removal of controls on the prices of domestically produced crude oil (first gradual, and then total), U.S. oil companies would be expected to derive substantially higher revenues and profits from the new price levels. Many outside the oil industry held that much of the additional profit would be an unearned "windfall" that should be recovered through a tax, which should be used to assist the financing of other energy objectives and related energy programs, and for equity and income-distribution reasons. Opponents of such a tax argued that it would yield at least two unwanted results. First, they said, the tax would remove some of the profits from oil operations that would other-

wise go into exploration to increase the oil and gas supplies available to meet U.S. needs. Second, the tax would further reduce the financial incentives to produce more oil, especially from higher-cost marginal properties, and some incentive to engage in more risky and/or deeper exploration activities.

It should be noted that proposals for a tax to reduce or eliminate "windfall profits" on the production or sale of petroleum or its products has roots at least as far back as the 1973-1974 oil embargo. The Crude Oil Equalization Tax put forward by President Carter in April 1977 and several excess profits tax proposals in 1973 and 1974 had approximately the same objective.

B. Issues

Much of the debate over WPT has centered around questions of to whom the increased revenues from decontrol should accrue, how the burden of any of such tax should be apportioned among oil producers, and the extent to which any tax will discourage domestic production of oil.

Windfall profit tax (WPT) proposals are, in theory, mechanisms for the redistribution of income and reallocation of resources -- the shifting of anticipated industry revenues to the general public or to low-income groups, or for use in energy conservation and alternative energy development. In 1979, there was concern that higher energy prices resulting from decontrol would redistribute income from low- and middle-income groups to company stockholders and other owners of oil producing properties, who tend to have higher than average incomes. Those with oil interests contended that such redistribution was an appropriate correction of distortions in income distribution caused by oil price controls.

Those advocating a WPT contended that a substantial portion of the additional profits earned by the oil companies as a result of decontrol from wells

that were producing oil before decontrol should be considered excessive. This was asserted on the grounds that the world price is an artificially set monopoly price, rather than a truly economic (free market) price, that much of the additional profits do not represent a reward for risk undertaken, and that, for many properties already producing oil, higher prices and profits would provide little incentive for additional production since little additional oil can be obtained. Opponents of the WPT responded that supply and demand interaction rather than production cost is the normal and appropriate determinant of price and replacement value, and that the price charged by an OPEC country--even though a monopoly price--is the true replacement value. Only this true economic price, it is reasoned, will provide sufficient funds to undertake new exploration, development and production. Arguments pertaining to OPEC monopoly pricing have been less central during 1981, when oil market slack has caused an actual, if temporary, decline in the real price of oil. (This slack has been caused primarily by Saudi Arabia's continued high production and by a drop in world oil consumption in response to higher prices and weakened economic conditions.)

Some recognition was given to the idea that certain categories of oil--heavy crude, "stripper" oil (from wells producing 10 barrels per day or less), and oil produced by advanced ("tertiary") recovery techniques, for example--require the economic incentive offered by world prices because of the higher costs associated with their production. Too great a reduction of the revenue gains resulting from decontrol might act to reduce significantly or eliminate producer incentives to raise domestic production of these categories.

Controversy over the windfall profit tax has persisted after its passage as part of the Crude Oil Windfall Profit Tax Act of 1980, and subsequent modifications. There is still some strong objection, especially within the oil industry, to the tax as a whole and to many of its details. 1/ Debate over such a tax has spread to natural gas pricing, where this kind of tax is being considered as a concomitant to early decontrol of natural gas prices.

1/ See the archived Issue Brief "Oil Windfall Profits Tax" (IB 80010) for additional details on the context and the legislative history of the windfall profit tax in the 96th and 97th Congresses.

II. CONTEXT OF THE DEBATE

A. Controls on Oil

Federal controls on oil covered virtually all phases of production, refining, and distribution of crude oil and petroleum products. Controls originated in the Economic Stabilization Act of 1970 (P.L. 91-379), which gave the President broad powers, including the authority to allocate crude oil and petroleum products, to counteract any anticompetitive aspects of oil shortages, and to eliminate any windfall profits.

Three key pieces of legislation after 1970, which built on the Economic Stabilization Act and on each other, together fashioned the guidelines for the system of controls on petroleum prices and industry operations: the Emergency Petroleum Allocation Act of 1973 (P.L. 93-159); the Energy Policy and Conservation Act of 1975 (P.L. 94-163); and the Energy Conservation and Production Act of 1976 (P.L. 94-385). The mandatory price controls promulgated by these laws expired on May 31, 1979; but the President had an option to continue the controls through the end of September 1981.

By early 1979, domestically produced price-controlled crudes were priced significantly under world oil prices, and the gap was being steadily enlarged. President Carter exercised his option by implementing a scheme that would gradually decontrol prices of domestic crude oil between June 1, 1979, and September 30, 1981. At specified rates, crude oil in lower-priced categories (under the old control system) would move into higher-priced categories, resulting in all domestic crude oil becoming decontrolled at the final date. Prices of all major refined products except gasoline had been individually decontrolled between July 1976 and March 1979. President Carter did not lift or otherwise modify the controls on gasoline prices.

On January 28, 1981, newly inaugurated President Reagan removed the price controls on crude oil and gasoline completely. By then, only about one third of domestic crude production was still under price controls.

B. Oil Industry Tax Treatment

Debate on some of the issues connected with WPT proposals focused on prior tax treatment of the oil industry. It was held that oil and gas production had been receiving favorable tax treatment for many years, although one special provision, dealing with percentage depletion, was repealed for most oil and gas producers in 1975. Even without percentage depletion, a substantial portion of capital investment can be deducted when incurred, resulting in a lower effective tax rate than would occur under the standard tax system.

A lower tax rate leads to a greater allocation of capital to the production of oil and gas than would occur under a normal tax rate. Prior to the substantial price rises of foreign oil, a major reason advanced for special treatment of the petroleum industry (for example, lower taxes and import quotas) was national security, because foreign oil prices were relatively low and allegedly posed a threat to the existence of a domestic industry (vital in time of national emergency). Some contended, however, that because foreign oil prices have increased substantially and the price of new domestic oil has increased substantially as a result, favorable treatment of oil and gas is no longer appropriate. The counterargument is that WPT taxes amount to unfavorable treatment of oil and gas, when the need for domestic production of oil and gas is as great as ever.

C. Oil Industry Profits

Oil company profits have attracted wide attention since the 1973-1974 Arab oil embargo and subsequent large increases in world oil prices. Between 1972

and 1979 (the year President Carter proposed the WPT), aggregate net income after taxes (after-tax profits) of the Nation's 20 largest petroleum companies (size measured by total sales) quintupled. This very large overall increase is almost entirely the result of sharp jumps in profits that occurred between 1972 and 1974 and between 1978 and 1979--increases of 124 percent and 70 percent, respectively.

One can observe (from the above changes) that sharp gains in oil industry profits have coincided with periods of instability in the world supply and price of oil. Of course, profit increases in all industries during the last ten years reflect to some extent the substantial rise in the general price level in the economy; the implicit price deflator for the gross national product rose 63 percent between 1972 and 1979.

When return on assets for the 20 largest oil companies is compared with similar data for manufacturing and for large industrial firms over the last decade or so, however, a mixed picture emerges. Large oil company return on assets for 1970 through 1980 (6.56 percent) averages slightly lower than that for all manufacturing firms (6.84 percent), but somewhat higher than that for the 500 largest industrial companies (6.0 percent). Importantly, the same pattern holds for 1970-1973 as for 1974-1980. Generally, returns on sales and on assets generated by the top 20 oil companies for 1970-1980 are very close to those realized by manufacturing firms as a whole. 2/

D. Domestic Production

An important aspect of the debate on the WPT concerns the degree to which decontrol of oil prices will stimulate additional production of domestic oil.

2/ These longer term comparisons mask the much higher oil company profitability during particular years that draws public attention. For example, return on shareholders' equity in 1979 for the oil companies reported in Business Week magazine's "Corporate Scoreboard" was 21.6 percent, compared with 16.6 percent for all industries tallied in the "Scoreboard." (Business Week, March 17, 1980. p. 102, 103, 116.)

The structure of tax rates advocated naturally depends on perceptions of how price increases will affect production of individual categories of oil (e.g., old, new, tertiary) and overall production. These perceptions, in turn, hinge on estimates of the price elasticity of supply of domestic oil. Estimates of such elasticity range from as low as 0.05 for the short run (where there is insufficient time for investment to expand capacity) to around 1.0 for the long run. (Price elasticity of supply is the ratio of the percentage increase in production, brought about by a given increase in price, to the percentage of that increase in price.) Thus, an increase in supply of 10 percent in response to a 100-percent increase in price indicates an elasticity of 0.1. Estimates of oil supply price elasticity are uncertain because of the great diversity of oil-producing properties (regarding location, depth and age of wells, quality of oil produced, and other factors), the long lead times from initial exploration to production, and the uncertainty of discovery rates and levels.

In debating the price elasticity of supply of oil, however, one should be cognizant of the strong likelihood that domestic oil production will decline in the longer term, or at best remain stable. Therefore, any "increase" may represent merely a slower decline in production than would otherwise occur.

E. Use of the Revenues

Consideration of a new tax raises questions of how to dispose of the revenues. Congressional proposals for the WPT included earmarking all or part of the funds for specific energy or non-energy objectives. These objectives included greater energy efficiency, development of alternative energy sources, and encouragement of their use, softening the impact of higher energy prices on low-income families, and simple placement in the general fund. Techniques for financing these objectives include tax credits, grants, low-interest loans, and direct outlays for goods and services. The trust fund device was the most commonly proposed means of administering the disposition of WPT monies.

III. WINDFALL PROFIT TAX CHRONOLOGY

A. Initial Enactment

President Carter announced his intention to propose a windfall profit tax at the same time he presented his decontrol plan (energy message of April 5, 1979), and followed that announcement with a detailed legislative proposal later that month. ^{3/} Several other windfall profit tax bills were introduced by members of Congress. H.R. 3919 (96th Congress), one of the modifications of the President's original proposal, was introduced by Representative Ullman (Chairman of the Ways and Means Committee) on May 3 and passed the House of Representatives on June 28, 1979, as the Crude Oil Windfall Profit Tax Act of 1979. The Senate approved a somewhat different measure on December 17, 1979. The Conference Committee issued its compromise report on March 7, 1980. By March 27, both houses had voted to accept the Conference Report. President Carter signed the Crude Oil Windfall Profit Tax Act into law on April 2, 1980 (as P.L. 96-223).

Aside from levying a tax on domestic crude oil, the Act provides a variety of tax incentives for households and businesses to invest in specified kinds of equipment that substitute alternative forms of energy for oil or gas, or that reduce energy use (regardless of the energy source). The Act also contains a few provisions not related to energy.

Although the tax was subsequently modified in some respects, the basic form and structure of the so-called windfall profit tax called for in the 1980 Act has not been changed.

B. Post-enactment Objections

Some of the parties affected by the WPT began to move for changes in or

^{3/} Weekly Compilation of Presidential Documents, v. 15, nos 14 and 17, April 9, 1979, and April 30, 1979. p. 609-614, 721-727.

repeal of the law soon after its passage. There have been two main thrusts: (a) complaints by "small" owners and/or operators of oil producing properties, many of modest means, that they should not be subject to the same tax rates as the large oil companies; and (b) activities by producer or State organizations aimed at challenging the law itself on constitutional grounds, and/or challenging the manner in which the law is being implemented.

C. December 1980 Change

The 1980 Act subjected a royalty owner to the WPT in the same manner as integrated companies. Moreover, in most cases, royalty interests were not eligible for reduced windfall profit tax rates afforded independent producers. Royalty owners began to feel the impact of the tax on their royalty earnings in April 1980. In late July 1980, the Senate passed an income tax credit (or refund) for oil royalty owners of up to \$1,000 against the windfall profit tax incurred on the removal of oil during calendar year 1980. This action was part of the Senate's First Concurrent Budget Resolution for FY81, and became part of the Omnibus Reconciliation Act of 1980 (P.L. 96-499), enacted December 5, 1980. (The comparable House Resolution did not include such a provision.) 4/

D. Tax Act of 1981

Deliberations over general tax reduction in Spring and Summer 1981 renewed attention to the windfall profit tax. A large number of bills were formulated that would benefit independent oil producers, producers of "newly discovered" oil, and producers of stripper well oil, as well as royalty owners. The most commonly

4/ Additional discussion and information on the treatment of oil royalty owners under the windfall profit tax may be found in the following: U.S. Library of Congress. Congressional Research Service. Proposed Changes in the Windfall Profit Tax Treatment of Oil Royalty Owners. Report No. 81-163 E, by Bernard A. Gelb. Washington, 1981; U.S. Library of Congress. Congressional Research Service. Royalty Owners and the Windfall Profit Tax. Mini Brief No. 81243, by Bernard A. Gelb. Washington, updated periodically.

proposed method of reducing the WPT on a producer or royalty owner was the establishment of an average daily volume of production below which oil would not be subject to the tax.

Insofar as windfall profit tax items are concerned, the overall tax package that finally emerged from Congress resembled the House's version of the bill much more closely than the Senate version. The former provided for more extensive WPT reductions than the latter. The overall tax measure, designated the Economic Recovery Tax Act of 1981, was signed into law by President Reagan on August 13, 1981, as P.L. 97-34.

E. Legal Challenge

On October 14, 1980, a challenge to the originally enacted Windfall Profit Tax Act was filed in the U.S. District Court for the District of Wyoming by the Independent Petroleum Association of America, thirty associations of oil and gas producers and royalty owners, and several individual producers and royalty owners. They cited the following legal issues: (1) because the Act exempts certain crude oil production from Alaska, it violates the Constitutional clause that requires excise taxes to be levied uniformly (interpreted by the courts to mean geographic uniformity); (2) because economic analysis has shown that the tax will decrease domestic oil production, the Act increases (rather than decreases) dependence on foreign oil and, by defeating the purpose of its adoption, fails to provide due process of law; (3) the Act takes private property without just compensation.

A motion to dismiss the challenge, filed in December 1980 by the U.S. Department of Justice, was dismissed by the District Court judge on August 26, 1981, after a hearing in June 1981. At this writing, the parties have agreed to bypass a trial of the facts; and each will file, by February 16, 1982, a

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motion for summary judgment (on the legal issues) in its favor. Responses to these motions are due on April 16, 1982, two weeks after which the case will be argued in the District Court.

IV. PROVISIONS OF THE CRUDE OIL WINDFALL PROFIT TAX ACT, AS AMENDED

Despite its name, the "Windfall Profit Tax" is not a tax on profit but, in effect, a series of excise taxes imposed on the differences between the selling prices and "base" prices for the various categories of oil under the Act. The tax on oil in each category is calculated by multiplying the tax rate by the difference between the selling price and the base price, and multiplying that amount by the volume of oil produced in that category. The difference between the base price and the selling price is the "windfall profit" (per barrel).

The tax is temporary. It became effective March 1, 1980, and is to last about eleven years. More specifically, it is to be phased out over a 33-month period starting in January 1988, or in the month after the cumulative net revenues received as a result of the tax reach \$227.3 billion, the revenue target (distinct from the projected yield), whichever is later. But the phase-out will start no later than January 1991; and the tax must end by September 30, 1993, regardless of whether it has raised the targeted \$227.3 billion.

A. Tax Structure and Rates

The structure of the tax is as follows:

- * Tier One: A 70-percent tax is imposed on all taxable oil except oil specifically included in a higher tier (see below). The base price is set at \$12.81, adjusted quarterly for inflation (on the basis of the percentage increase in the implicit price deflator for the gross national product since the 2d quarter of 1979).
- * Tier Two: A 60-percent tax is imposed on "stripper oil" and oil produced from a National Petroleum Reserve in which the U.S. has an economic interest. The base price is \$15.20, ad-

justed for quality and location differences, and for inflation (as in Tier One).

- * Tier Three: As initially enacted, a 30-percent tax is imposed on oil discovered since January 1, 1979, certain heavy oil, and incremental tertiary oil. The base price is \$16.55, adjusted for quality and location differences, and by a factor equal to inflation (as in Tier One) plus roughly 2 percent per year. (More specifically, each quarterly increase in the implicit price deflator after September 1979 is multiplied by 1.005.) As subsequently modified by the Tax Act of 1981, the tax rate on newly-discovered oil is reduced according to the following schedule: 1982, 27.5 percent; 1983, 25.0 percent; 1984, 22.5 percent; 1985, 20.0 percent; and 1986 and thereafter, 15.0 percent.

This basic general structure is, however, modified in the original Act and subsequent Congressional action in a number of specific respects. Presented here are the main items.

- * Independent producers pay lower rates on their first 1,000 daily barrels of production in Tiers One and Two (50 percent in Tier One and 30 percent on Tier Two), prorated according to total production in each category eligible for reduced rates. Starting in 1983, all stripper well oil production by independents will be exempt from the tax. This exemption does not reduce the quantity of oil eligible for the lower rates. Stripper oil cannot qualify for the exemption if it is produced from a stripper well property that has been owned on or after July 22, 1981 by a non-independent.
- * Certain royalty owners receive a tax credit (or refund) of up to \$1,000 against the windfall profit tax on the removal of royalty

oil during calendar year 1980, and up to \$2,500 for 1981. The credit is available only to individuals, estates, and family farm corporations; it is not available to other corporations or to trusts. For 1982 through 1984, royalty owners' first 2 barrels per day of production are exempted from the tax; their first 3 barrels per day are exempted for 1984 and thereafter.

- * The windfall profit subject to the tax is reduced by the amount of a State severance tax on the windfall profit. There are restrictions as to the kind and level of severance tax that is applicable.
- * Alaskan North Slope oil that is produced from the Sadlerochit Reservoir is taxed as Tier One oil, except that the base price may be adjusted upward to reflect decreases in the Trans-Alaska Pipeline System tariff below \$6.26 per barrel. Other oil produced north of the Arctic Circle is exempt.
- * Oil from Indian land is exempt from the tax, as is oil from land owned by State and local governments if the proceeds are used for a public purpose.
- * The taxable windfall profit on a barrel of oil may not exceed 90 percent of the net income attributable to the barrel. Net income attributable to a barrel generally is determined on the basis of taxable income, but depletion and intangible drilling and development costs must be computed on the basis of cost depletion.
- * Charitable organizations that are organized and operated primarily for the residential placement, care, or treatment of delinquent, dependent, orphaned, neglected, or handicapped children are exempt from the tax. 5/

5/ This provision refers to charitable organizations that own oil-producing property.

B. Allocation and Use of Funds

As noted in the Introduction, the windfall profit tax was conceived as a mechanism for the redistribution of income and reallocation of resources. But the disposition of the revenues is not provided for in a straightforward manner by the Crude Oil Windfall Profit Tax Act of 1980, although most of the text of the Act deals with the means by which Federal funds are to be devoted to energy and other goals.

Most important, the Act neither authorizes nor appropriates the expenditure of expected WPT revenues except for an exceedingly small portion. With this one exception, and that unclear, it only provides that the net revenues 6/ from the windfall profit tax be allocated to a separate account in the Treasury, for accounting purposes only. Without separate specific authorizing and appropriating action by Congress, WPT receipts are, in effect, spent along with other general funds in the Treasury. The net revenues allocated to the "account" mentioned above are to be further allocated to subaccounts for the uses shown below, in the proportions shown:

- * Income tax reductions -- 60 percent of net revenues;
- * Aid to lower income families -- 25 percent of net revenues;
- * Energy and transportation programs -- 15 percent of net revenues.

The one authorizing action of the Act is for assistance to low income families for heating and cooling costs (see Section E, below).

Although not related to the allocation formula, a major thrust of the Act is to enhance Federal encouragement of residential and business energy conservation and of the production and use of alternative energy sources. The Act makes various additions and changes to previously existing devices such as tax

6/ The meaning of "net" revenues is explained in Chapter V.

credits and exemptions. Major items are listed below.

The Windfall Profit Tax Act deals with a number of matters other than the so-called windfall profit tax on domestic crude oil. These non-oil tax provisions are summarized below.

C. Residential Energy Tax Credits

- * The tax credit for solar, geothermal, and wind energy property is increased to 40 percent of the first \$10,000 of expenditures from 30 percent of the first \$2,000 and 20 percent of the next \$8,000.
- * Equipment used to generate electricity from the above renewable energy sources is made eligible for the credit. Renewable energy source property includes installation of solar panels as a roof or part of a roof.
- * Specific standards are set for the Secretary of the Treasury to apply when he exercises authority to add new items to the list of property eligible for energy tax credits.
- * Qualified expenditures and the expenditure limits per dwelling are reduced to the extent that property is financed by grants or subsidized energy loans. In cases of joint ownership of two or more dwelling units used as principal residences, the credit is available separately for the expenditure made by each taxpayer.

D. Business Energy Tax Incentives

- * The tax credit for solar, wind, and geothermal energy property is increased from 10 percent to 15 percent for 1980 through 1985, and solar process heat equipment is made eligible; any refundable features are repealed.
- * The 10-percent investment credit for equipment to produce a solid

fuel from biomass is extended from 1982 through 1985; and the 10-percent credit for equipment to convert biomass to alcohol for fuel use is extended to 1985 if the primary source of energy for the converting equipment is a substance other than oil, natural gas, or products of oil or natural gas.

- * Certain intercity bus operators get a 10-percent credit through 1985 for purchases that increase seating capacity.
- * The existing exemption from the 4-cents-a-gallon excise tax on gasoline allowed blenders of alcohol with gasoline is extended from 1984 to 1992. Where the excise tax exemption does not apply, gasohol blenders are provided an income tax credit of 40 cents for each gallon of alcohol. Other advantages for gasohol are also provided.
- * Subject to various conditions, producers of certain alternative energy sources get a tax credit of \$3 per barrel of oil equivalent, adjusted for inflation; the qualifying sources are oil from shale and tar sands, natural gas from certain nontraditional sources, synthetic fuels (other than alcohol) from coal, gas from biomass, steam from solid agricultural byproducts, and processed wood.
- * Solid waste disposal facilities eligible for financing with tax-exempt industrial development bonds would include certain property used primarily to convert fuel derived from solid waste into steam as long as such property and that used for collection and processing of the waste is owned by the same person. Interest received on an obligation used to finance a solid waste disposal facility and a related electric energy facility is also tax exempt under certain circumstances.
- * Interest received on industrial development bonds used to finance renewable energy property is exempted from income tax in States that meet certain legal requirements.

- * Small-scale hydroelectric facilities, including those of public utilities, are provided an 11-percent nonrefundable credit. Property is eligible for the credit if the installed capacity of all hydroelectric generating equipment at the site is less than 125 megawatts, and if it is installed at the site of an existing dam (completed before October 18, 1979) or at a new or existing water flow that is not at the site of a dam.
- * Under certain conditions, tax-exempt industrial development bonds may be used to finance hydroelectric facilities at existing dam sites or at sites where no dam or other water impoundment is involved.
- * A 10-percent energy credit through 1982 is provided for "cogeneration" equipment added to an existing boiler or burner in which less than 20 percent of the annual fuel consumed is accounted for by oil or natural gas.

E. Low-income Energy Assistance

- * Assistance to lower-income families for heating and cooling costs is provided by means of authorization of \$3.0 billion for fiscal year 1981 (through block grants to states under a complex allocation formula). An additional \$90 million is authorized for a specified procedural contingency.
- * Additional assistance to lower-income families is purportedly "allocated" (not authorized or appropriated) through the statement of general intent (discussed on page 16). This says that 25 percent of projected net revenues of the WPT and one third of any net revenues in excess of the projected amount are for lower-income families.

F. Miscellaneous Provisions

The Act also includes some provisions that do not pertain to energy or to energy-related concerns. As can be seen in Table 1, three of these provisions have large budget effects. Major items, including the three, follow:

- * The Act establishes Congressional veto authority, by means of a joint disapproval resolution, over any action taken by the President (such as imposition of fiscal levies or import quotas) to adjust imports of petroleum or its products under the national security provision (sec. 232) of the Trade Expansion Act of 1962. The resolution could be vetoed by the President, but the veto could be overridden by a two-thirds vote of both Houses.
- * The existing exclusion of up to \$100 in dividends (\$200 for married couples) from income for individual tax purposes was broadened to include interest, and increased to \$200 (\$400 for couples). This change would apply to 1981 and 1982 income taxes.
- * Taxpayers who liquidate their LIFO ^{7/} inventories in response to a Department of Energy regulation or request, or to a major foreign trade interruption, may apply for a refund of taxes paid on the LIFO inventory profits of such sale if the liquidated inventory is replenished within three years.
- * A liquidating corporation (with some exceptions) must recognize the amount of its LIFO recapture as ordinary income. Also, a corporation selling its assets in the course of a 12-month liquidation must recognize the amount of its LIFO recapture as income.

^{7/} LIFO inventory accounting bases costs of goods sold on the "last-in-first-out" principle; that is, goods acquired last are presumed to have been sold first.

V. REVENUE EFFECTSA. Projections

At the time of passage of the Crude Oil Windfall Profit Tax Act of 1980, the Joint Committee on Taxation projected that gross collections of the tax would total \$410.5 billion. But, because the WPT is a deductible item, the windfall profit tax reduces regular corporate income tax receipts below what they would be with decontrol and without the windfall profit tax. This reduction was estimated at \$182.8 billion, thus yielding the projected net revenues of \$227.7 billion (see Table 1).

Other parts of the Act provide for increases in various residential energy tax credits, business energy tax incentives, and other changes in the tax law. In the conference report on the Act, 8/ these were projected to cost the Treasury a net of \$15.5 billion in the 1980-1990 period. Table 2 summarizes the estimated revenue effects of the broad categories of tax changes in the Act for individual calendar years and for the entire period.

The cost to the Treasury of the royalty owner credit of \$1,000 for 1980 (enacted in December 1980) was estimated at \$180 million in reduced revenues. 9/

Changes in the windfall profit tax made by the Economic Recovery Tax Act of 1980 are estimated to have a substantial, if not major, impact on revenues from the tax. Over the ten-year period to which the changes will apply, net

8/ U.S. Congress. Conference Committees, 1980. Crude Oil Windfall Profit Tax Act of 1980; conference report to accompany H.R. 3919. Washington, U.S. Govt. Print. Off., 1980. 180 p. (96th Cong., 2d sess. House. Report 96-817.)

9/ U.S. Congress. Conference Committees, 1980. Omnibus Reconciliation Act of 1980; conference report to accompany H.R. 7765. Washington, U.S. Govt. Print. Off., 1980. p. 198. (96th Cong., 2d sess. House. Report No. 96-1479.)

TABLE 1. Estimated Revenue Effect of the Original Crude Oil
Windfall Profit Tax, Calendar Years, 1980-90
(millions of dollars)

Item	Calendar Year Liabilities a/					
	1980	1981	1982	1983	1984	1985
Gross windfall profit tax	10,876	25,952	33,534	35,952	38,202	40,104
Change in income taxes	-4,570	-11,234	-14,659	-15,805	-16,890	-17,837
Net windfall profit tax	6,306	14,719	18,875	20,147	21,312	22,267
Item	Calendar Year Liabilities a/					Total
	1986	1987	1988	1989	1990	1979-1990
Gross windfall profit tax	41,445	43,185	44,789	47,049	49,399	410,486
Change in income taxes	-18,538	-19,407	-20,200	-21,278	-22,382	-182,763 b/
Net windfall profit tax	22,907	23,778	24,588	25,771	27,017	227,723

a/ Amounts estimated to be incurred by taxpayers and owed to the Treasury as a result of operations during the calendar year indicated.

b/ Total includes a small amount of income tax revenue expected to be raised in 1979 (because the tax on newly discovered oil reduces intangible drilling deductions that year), which is not shown separately.

NOTE: Details may not add to totals because of rounding.

Source: U.S. Congress. Conference Committees, 1980. Crude Oil Windfall Profit Tax Act of 1980; conference report to accompany H.R. 3919. Washington, U.S. Govt. Print. Off., 1980. p. 168. (96th Cong., 2d sess. House. Report No. 96-817.)

TABLE 2. Summary of Revenue Effects of the Original Crude Oil Windfall Profit Tax Act of 1980, As Estimated Before Passage of the Law (millions of dollars)

ITEM	Calendar Year Liabilities a/						1985
	1979 b/	1980	1981	1982	1983	1984	
Net gain from windfall profit tax .	36	6,306	14,719	18,875	20,147	21,312	22,267
Residential energy tax credits	--	-42	-53	-69	-97	-138	-201
Business energy tax incentives	-3	-146	-232	-329	-864	-1,182	-1,541
Repeal carryover basis	--	--	-36	-95	-163	-238	-330
Interest and dividend exclusion ...	--	--	-2,095	-2,210	--	--	--
Involuntary liquidation of LIFO inventories	--	--	-85	-85	-80	--	--
Taxing inventory profits at corporate liquidations	--	--	--	250	250	250	250
TOTAL	33	6,118	12,218	16,337	19,193	20,004	20,445

ITEM						Total
	1986	1987	1988	1989	1990	1979-1990
Net gain from windfall profit tax .	22,907	23,778	24,588	25,771	27,017	227,723
Residential energy tax credits	--	--	--	--	--	-600
Business energy tax incentives	-824	-887	-1,044	-626	-616	-8,297
Repeal carryover basis	-440	-560	-680	-810	-950	-4,302
Interest and dividend exclusion ...	--	--	--	--	--	-4,305
Involuntary liquidation of LIFO inventories	--	--	--	--	--	-250
Taxing inventory profits at corporate liquidations	250	250	250	250	250	2,250
TOTAL	21,893	22,581	23,114	24,585	25,701	212,219

a/ Amounts estimated to be incurred by taxpayers (and owed to the Treasury as a result of operations during the calendar years indicated.

b/ A small amount of tax revenues would be raised in 1979, because the tax on newly discovered oil reduces intangible drilling deductions in that year.

Source: U.S. Congress. Conference Committees, 1980. Crude Oil Windfall Profit Tax Act of 1980; Conference report to accompany H.R. 3919. Washington, U.S. Govt. Print. Off., 1980. p. 164-165. (196th Cong., 2d sess. House. Report No. 96-817.)

WPT revenues will be an estimated \$32.3 billion less than originally projected, as a result of the 1981 Act (see Table 3).

B. Collections and Contingencies

WPT collections cannot be ascertained until at least several months after receipt, and then only indirectly. This is a consequence of the nature of the excise tax filing and recording system used by the Internal Revenue Service (IRS). Depending upon the category of producer or purchaser, the Windfall Profit Tax Act requires the WPT to be paid anywhere from a few days to two-

TABLE 3. Estimated Revenue Effects of the Provisions of the Economic Recovery Tax Act of 1981 that Relate to the Crude Oil Windfall Profit Tax (billions of dollars)

<u>Provision</u>	<u>Calendar Years</u>					
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
\$2,500 royalty credit for 1981; partial exemption for 1982 and, thereafter	-0.5	-0.9	-1.0	-1.0	-1.3	-1.3
Reduction of tax on newly discovered oil	--	-0.1	-0.3	-0.6	-1.0	-1.8
Exempt independent producer stripper well oil	--	--	-0.7	-0.7	-0.8	-0.8
Exempt child care agencies	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>
TOTAL	0.5	1.0	2.0	2.3	3.0	3.9
	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>Total 1981-1990</u>	
TOTAL	4.3	4.7	5.1	5.4	32.3	

a/ \$15 million.

Notes: Data for individual provisions are not available for 1987 through 1990. Details may not add to totals due to rounding.

Source: Joint Committee on Taxation, U.S. Congress. Telephone communication.

and-a-half months after removal of oil from a property. As is the case with all excise taxes, however, the documentation that accompanies WPT payments does not identify the specific tax being paid; moreover, such payments can be, and are, combined with payments of other excise taxes. The Quarterly Excise Tax Returns, filed two months after the end of the quarter to which they pertain, do identify each type of tax, but reflect liabilities rather than collections. A Windfall Profit Tax form, which shows how the incurred tax has been computed and when payments were made, is filed with the Quarterly Excise Tax Return. But because of differences in timing, some deposits in payment of a portion of liabilities incurred in one calendar quarter are made in the succeeding quarter. The presumed "final" accounting for windfall profit tax liability and payment by a particular taxpayer may not even occur when the taxpaying entity files its regular annual tax return two-and-a-half months after the end of its fiscal year.

Because of these difficulties in relating collections to liabilities, IRS accounting for the WPT is based on liabilities that are reported on the Quarterly Excise Tax Return. Moreover, the availability of the information on these forms is delayed by the time needed to process and record the data as well as by the gap between the end of the respective calendar quarters and the dates when the returns are filed.

Based upon data from this imperfect information processing system and taking into account the gaps built into it, revenues appear to be coming into the Federal treasury at roughly the same rate projected in the Conference Report. When enacted, the tax was projected to yield \$10.9 billion in gross liabilities in calendar year 1980. Gross liabilities recorded from March 1, 1980 (when the tax became effective) through April 30, 1981, amounted to \$8.9 billion. This figure roughly reflects WPT liabilities reported for periods

through the quarter ending December 31, 1980; it necessarily excludes 1980 liabilities that will be reported in later returns. A special tabulation by IRS based on liability quarters shows that gross WPT liabilities for calendar year 1980 were \$9.9 billion (see Table 4). The Treasury Department has estimated that gross WPT revenues in calendar year 1980 totalled \$10.0 billion.

TABLE 4. Windfall Profit Tax Liability, Calendar Year 1980
(millions of dollars)

<u>Liability Quarter Ending</u>	<u>Liability After Adjustments a/</u>
March 1980 <u>b/</u>	788
June 1980	2,821
September 1980	3,325
December 1980	<u>2,991</u>
TOTAL	9,925

a/ Data for each quarter also reflect deductions from, or additions to, liabilities incurred in that quarter to adjust for overwithholding or underwithholding in one or more previous quarters.

b/ The windfall profit tax took effect March 1, 1980.

NOTE: Not all of the windfall profit tax liability for a given quarters is deposited in that quarter, because of varying deposit rules.

Source: U.S. Department of the Treasury. Internal Revenue Service. Statistics of Income Bulletin. v. 1, no. 2 (Fall 1981). p. 50.

Present and possible future softness in demand for petroleum products does not, at this point, threaten a substantial shortfall of future WPT revenues below projected levels. Decreases in domestic demand for oil result almost entirely in reductions in imports in petroleum rather than in domestic production (which is the base of WPT revenues). Some analysts believe that forecasts of domestic crude oil production made in early 1980 may have been

moderately optimistic; but a moderate "shortfall" in production will almost certainly be offset by the considerable increase in oil prices that has occurred since the 1980 projections were made. The present softness in world oil prices may be eliminated by the recent Saudi Arabian decision to reduce its crude oil production by about 1.5 million barrels per day. (This decision followed the agreement by the Organization of Petroleum Exporting Countries to "unify" prices.)

Another uncertainty is how much additional windfall profit tax revenue may result from improvements now being planned in the management of oil royalty collections from Federal lands.

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