[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS
(S. 233, S. 255, and S. 302)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

SENATE COMMITTEE ON FINANCE

ON JANUARY 30, 1987

PREPARED BY THE STAFF

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INTRODUCTION

The Senate Finance Subcommittee on Energy and Agricultural Taxation has scheduled a public hearing on January 30, 1987, on three energy-related tax bills: (1) S. 233 (relating to oil and gas income tax provisions); (2) S. 255 (repeal of the crude oil windfall profit tax); and (3) S. 302 (excise tax on imported crude oil and petroleum products).

The first part of the pamphlet [1] is a summary of the bills. The second part is a description of the bills, including present law, explanation of the bills, and related issues.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of Tax Bills (S. 233, S. 255, and S. 302)* (JCS-1-87), January 30, 1987.

I. SUMMARY

1. S. 233—Senators Boren and Bingaman

Income Tax Amendments Related to Domestic Oil and Gas Production

This bill would provide additional income tax incentives for domestic oil and gas production. Among these, the bill would increase the percentage depletion rate if the taxpayer's average removal price for crude oil is less than $20 per barrel, repeal the 50 percent of net income limitation on percentage depletion, and allow transferred properties to qualify for percentage depletion. (A similar anti-transfer rule also would be repealed for windfall profit tax purposes.) The bill also would eliminate recapture of intangible drilling and development costs ("IDCs") and depletion upon disposition of an oil, gas or geothermal property, and treat geological and geophysical costs and surface casing costs as expensible IDCs.

These provisions generally would be effective on the date of enactment, except that the increase in the percentage depletion rate (if applicable) would be effective for calendar years beginning after 1986.

2. S. 255—Senators Boren and Bingaman

Repeal of Crude Oil Windfall Profit Tax

Present law imposes a tax (the crude oil windfall profit tax) on the windfall profit element of domestically produced crude oil. The tax is scheduled to phase out over a 33-month period beginning in January, 1991, or earlier if revenues exceed a specified amount.

The bill would repeal the crude oil windfall profit tax, effective for oil removed after the date of enactment.

3. S. 302—Senators Boren and Bingaman

Excise Tax on Imported Crude Oil and Petroleum Products

This bill would impose an excise tax on the sale or use of imported crude oil and certain products refined from imported crude oil if the average price is less than $18 per barrel for the preceding four weeks. An exception to the tax is made for imported oil held or sold for export.

II. DESCRIPTION OF THE BILLS

1. S. 233—Senators Boren and Bingaman

Income Tax Amendments Related to Domestic Oil and Gas Production

Present Law

Intangible drilling and development costs

General rules

Costs incurred by an operator to develop an oil or gas property for production are of two types: (1) intangible drilling and development costs, and (2) depreciable costs. The acquisition price for the oil- or gas-producing property, and geological and geophysical costs are recovered through depletion deductions (see discussion below).

Amounts paid or accrued to acquire tangible property ordinarily considered to have a salvage value (e.g., tools, pipe, cases, tubing, engines, etc.) are recovered through depreciation deductions. No election is permitted with respect to these costs.

Under present law, domestic intangible drilling and development costs ("IDCs") may either be currently expensed or else may be capitalized and recovered through depletion or depreciation deductions (as appropriate), at the election of the operator. In general, IDCs include expenditures by the property operator incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas (or geothermal energy) which are neither for the purchase of tangible property nor part of the acquisition price of an interest in the property. IDCs include amounts paid for labor, fuel, repairs, hauling, supplies, etc., to clear and drain the well site, make an access road, and do such survey and geological work as is necessary to prepare for actual drilling. Other IDCs are paid or accrued by the property operator for the labor, etc., necessary to construct derricks, tanks, pipelines, and other physical structures used to drill the wells and prepare them for production. IDCs include amounts paid or accrued to drill, shoot, and clean the wells. IDCs also include amounts paid or accrued by the property operator for drilling or development work done by contractors under any form of contract.

Only persons holding an operating interest in a property are entitled to deduct IDCs. This includes an operating or working interest in any tract or parcel of oil- or gas-producing land either as a fee owner, or under a lease of any other form of contract granting working or operating rights. In general, the operating interest in an oil or gas property must bear the cost of developing and operating the property. The term operating interest does not include roy-

alty interests or similar interests such as production payment rights or net profits interests.

Generally, if IDCs are not expensed, they can be recovered through depletion or depreciation, as appropriate. If IDCs are capitalized, costs paid or incurred with respect to a nonproductive well ("dry hole") may nonetheless be deducted as an ordinary loss, at the election of the operator, in the taxable year in which the dry hole is completed. Thus, a taxpayer has the option of capitalizing IDCs for productive wells while expensing those relating to dry holes.

Thirty-percent reduction for integrated producers

In the case of a corporation which is an integrated oil company (i.e., which is not an independent producer) [2] the allowable deduction with respect to domestic IDCs is reduced by 30 percent. (The Tax Reform Act of 1986 increased this amount from 20 percent.) The disallowed amount must be added to the basis of the property and amortized over a 60-month period, starting with the month in which the costs are paid or accrued. Amounts paid or accrued with respect to nonproductive wells (dry hole costs) are fully deductible in the taxable year in which the nonproductive well is completed.

Treatment of foreign IDCs

Under a provision added by the Tax Reform Act of 1986, IDCs incurred with respect to properties located outside the United States no longer qualify for expensing. Instead, these costs must be recovered (1) using 10-year, straight-line amortization beginning in the year paid or incurred, or (2) at the taxpayer's election, as part of the basis for purposes of any deduction allowable under section 611.[3]

Recapture

When a taxpayer disposes of an oil, gas, or geothermal property, a portion of the gain must be treated as ordinary income instead of capital gain (sec. 1254 of the Code). For property placed in service on or after January 1, 1987, the amount subject to such "recapture" is equal to the lower of (1) the amount of IDCs deducted (which, but for being deducted, would have been reflected in the adjusted basis of the property), plus depletion deductions that reduced the adjusted basis of the property, or (2) the gain on the sale, exchange, or involuntary conversion of the property.

For property placed in service before January 1, 1987,[4] the recapture amount is equal to the lower of (1) the amount of IDCs deducted since January 1, 1976 (which, but for being deducted, would have been reflected in the adjusted basis of the property), reduced by the amount (if any) by which the depletion deduction with respect to such property would have been increased if such amounts had been capitalized, or (2) the gain on the sale, exchange, or involuntary conversion of the property. Thus, for such property, IDC

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[2] These terms are defined in the same manner as for purposes of percentage depletion (discussed below).

[3] *See* discussion of depletion, below.

[4] This rule also applies to property acquired pursuant to a binding, written contract in effect on September 25, 1985. The recapture computation was amended by the Tax Reform Act of 1986.

(but not depletion) deductions are recaptured upon disposition of the property.[5]

Minimum taxes

IDC deductions on successful oil and gas wells are a tax preference item for purposes of the individual and corporate alternative minimum taxes, to the extent that the taxpayer's excess IDCs exceed 65 percent of the taxpayer's income from oil and gas properties. (Geothermal properties are treated in a similar manner.) Excess IDCs are defined generally as (1) IDC deductions (attributable to successful wells) for the taxable year, minus (2) the amount that would have been deductible in that year had the IDCs been capitalized and recovered over a 10-year, straight-line amortization period. At the election of the operator, the cost depletion method may be substituted for the 10-year amortization schedule in determining the amount of tax preference.

IDCs are not treated as tax preference items if the taxpayer elects to amortize IDCs over a 10-year period.

Depletion

General rules

Certain costs incurred prior to drilling an oil- or gas-producing property are recovered through depletion deductions. These include costs of acquiring the lease or other interest in the property, and geological and geophysical costs. Depletion is available to any person having an economic interest in a producing property (including a royalty interest).

Depletion is computed using whichever of two methods results in a higher deduction: cost depletion or percentage depletion. Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining to be recovered at the beginning of the taxable year. The amount recovered under cost depletion cannot exceed the taxpayer's basis in the property.

Under percentage depletion, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year. The amount deducted may not exceed 50 percent of the taxable income from the property for the taxable year, computed without regard to the depletion deduction (the "net income limitation"). Additionally, the deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions).[6] Because percentage depletion is computed without regard to the taxpayer's basis in a property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

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[5] Under the Tax Reform Act of 1986, the capital gain rate for individuals is conformed to the rates on ordinary income, effective in calendar year 1988. For calendar year 1987, a maximum 28-percent rate applies. The capital gain rate for corporations is 34 percent for gain recognized on or after January 1, 1987.

[6] Amounts disallowed as a result of this rule may be carried forward into later taxable years.

Limitation to independent producers, etc.

Under present law, percentage depletion for oil and gas properties is limited to independent producers and royalty owners [7] (as opposed to integrated oil companies), for up to 1,000 barrels of average daily domestic crude oil production or an equivalent amount of domestic natural gas.[8] For producers of both oil and natural gas, this limitation applies on a combined basis.[9]

For purposes of percentage depletion, an independent producer is any producer who is not a "retailer" or "refiner." A retailer is any person who directly, or through a related person, sells oil or natural gas or any product derived therefrom (1) through any retail outlet operated by the taxpayer or related person, or (2) to any person obligated to market or distribute such oil or natural gas (or product derived therefrom) under the name of the taxpayer or the related person. Bulk sales to commercial or industrial users, and bulk sales of aviation fuel to the Department of Defense, are excluded. Further, a person is not a retailer within the meaning of this provision if the combined gross receipts of that person and all related persons from the retail sale of oil, natural gas, or any product derived therefrom do not exceed $5 million for the taxable year.

A refiner is any person who directly or through a related person engages in the refining of crude oil, but only if such taxpayer or related person has a refinery run in excess of 50,000 barrels for any day during the taxable year.

To prevent proliferation of the independent producer exception, all production owned by businesses under common control, or by members of the same family, must be aggregated for purposes of these rules. Further, if an interest in a proven oil or gas property is transferred after 1974, production from such interest does not qualify for percentage depletion. Exceptions to this rule are provided in the case of transfers at death, to controlled corporations, and between controlled corporations or certain other business entities.[10]

Similar depletion rules apply to geothermal deposits located in the United States, except that the 1,000-barrel-per-day and 65 percent of taxable income limitations do not apply.

Minimum tax

Percentage depletion, to the extent that it exceeds the adjusted basis of the property, is a preference item for purposes of the individual and corporate minimum taxes.

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[7] Under a provision added by the Tax Reform Act of 1986, percentage depletion is not available for lease bonuses, advance royalties, or other amounts paid without regard to actual production from a property.

[8] As originally enacted, the depletable oil quantity was 2,000 barrels of average daily production; however, this was phased down to 1,000 barrels for 1980 and thereafter.

[9] Certain regulated natural gas, natural gas sold under a fixed contract, and natural gas from geopressured brine is exempt from the 1,000 barrel per day limitation.

[10] A similar anti-transfer rule applies for purposes of the exemption from the crude oil windfall profit tax for independent producer stripper well oil. (*See*, the discussion of the windfall profit tax under S. 255, below.)

Treatment of geological and geophysical costs and surface casing costs

Under present law, geological and geophysical expenditures for the purpose of identifying and locating productive mineral properties must be capitalized and recovered through depletion deductions. These may include expenditures for reconnaissance surveys over a broad area, and more detailed surveys within an identified area of interest. Geological and geophysical costs may be deducted as an ordinary business loss (sec. 165) if the entire area of a survey is abandoned as a potential source of mineral production.[11]

The IRS has ruled that the cost of casing (including surface and production casing) and associated equipment must be capitalized and recovered through depreciation deductions, since the casing is deemed to have a salvage value.[12] Labor and other costs of installing casing may be deducted as IDCs.

Explanation of the Bill

Increase in percentage depletion rate; repeal of net income limitation

The bill would increase the percentage depletion rate for oil and natural gas, if the taxpayer's average removal price for oil and gas sold during the calendar year is $20 per barrel or less. The amount of the increase would depend upon the average annual removal price, as shown in the following table:

If the average annual removal price during the calendar year is:	*The applicable percentage is:*
Less than $10	30 percent
$10 to $15	25 percent
$15 to $20	20 percent
Greater than $20	15 percent

The "average annual removal price" for the taxpayer would be determined by dividing the taxpayer's aggregate production of domestic crude oil or natural gas for the calendar year by the aggregate amount for which such production was sold.[13] For example, if a taxpayer sold 100,000 barrels of crude oil for an aggregate price of $1.8 million in calendar year 1988, the taxpayer's average removal price would be $18 per barrel, and a percentage depletion rate of 20 percent would apply to all production by that taxpayer in 1988. In the case of crude oil or natural gas sold between related persons, removed before sale, or refined on the production premises, a constructive sales price would be used (secs. 613 and 4988(c)).

The bill would repeal the 50 percent of net income limitation on percentage depletion deductions for oil and gas wells. Thus, percentage depletion would equal the specified percentage of gross income from each property, without regard to the net income from

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[11] *See*, Rev. Rul. 77-188, 1977-1 C.B. 76; Rev. Rul. 83-105, 1983-2 C.B. 51.

[12] *See* Rev. Rul. 70-414, 1970-2 C.B. 132; Rev. Rul. 78-13, 1978- 1 C.B. 63.

[13] Presumably the legislation intends that the average annual removal price be determined by dividing removal production in barrel-of-oil equivalents into the amount for which such production was sold.

that property. The 65-percent taxable income limitation of present law would continue to apply.

Percentage depletion would continue to be limited to 1,000 barrels per day of domestic crude oil production (or an equivalent amount of natural gas) by independent producers.[14] Additionally, the limitation on percentage depletion deductions for all oil and gas properties, to 65 percent of the taxpayer's overall taxable income, would remain in effect.

Effective date.—The changes in the percentage depletion rate would be effective for production during calendar years beginning after December 31, 1986. The repeal of the net income limitation would be effective for taxable years beginning after the date of enactment.

Repeal of anti-transfer provisions

Percentage depletion.—The bill would repeal the anti-transfer provisions for purposes of the 1,000 barrel per day limitation on percentage depletion. Thus, proven oil and gas properties could be transferred to an independent producer and qualify for percentage depletion. Percentage depletion would continue to be limited to 1,000 barrels of average daily production by each transferee (including production from transferred and other properties).

Windfall profit tax.—The bill would allow transferred properties to qualify for the independent producer stripper well exemption from the crude oil windfall profit tax. Thus, oil could qualify as exempt stripper well oil, although the oil is attributable to a proven property interest that was owned by a person other than an independent producer after July 22, 1981.

Effective dates.—The repeal of the percentage depletion anti-transfer rules would be effective for production after the date of enactment, in taxable years ending after that date. The amendment to the crude oil windfall profit tax would be effective for crude oil removed after the date of enactment.

Repeal of recapture on disposition of oil, gas or geothermal property

The bill would repeal the rules providing for recapture of intangible drilling cost deductions upon disposition of an oil, gas or geothermal property (sec. 1254 of the Code). This repeal would also apply to the recapture of certain depletion deductions on property placed in service after 1986.[15]

Effective date.—This provision would be effective for dispositions of oil, gas or geothermal properties after the date of enactment.

Treatment of geological, geophysical, and surface casing costs as IDCs

Under the bill, domestic (including U.S. possessions) surface casing costs and geological and geophysical costs would be treated in the same manner as intangible drilling and development costs for tax purposes. Thus, these costs would qualify for expensing at

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[14] The bill would repeal the anti-transfer provisions for purposes of this limitation (see discussion below).

[15] The bill would not affect recapture of mining exploration and development costs (secs. 617(d) and 1254).

the election of the operator, subject to a 30-percent reduction for integrated oil companies.[16]

Effective date.—This provision would be effective for costs paid or incurred after the date of enactment, in taxable years ending after that date.

Issues

Repeal of anti-transfer rules

Since 1975, the use of the percentage method for computing depletion deductions for oil and gas wells has been restricted to independent producers and royalty owners for limited amounts of crude oil and natural gas.

At the time these restrictions were enacted, Congress recognized that taxpayers would attempt to maximize the amount of oil and gas eligible for percentage depletion by transferring ownership interests. Consequently, the 1975 Act specifies that the limitation on the amount of oil and gas eligible for percentage depletion is to be computed by aggregating the production of related parties. In addition, the 1975 Act generally disallows percentage depletion with respect to transfers of proven oil and gas property.

The anti-transfer rules prevent integrated producers from indirectly obtaining the benefits of percentage depletion by selling productive oil and gas property to independents. The anti-transfer rules also prevent independent producers with less than 1,000 barrels per day of average production from buying proven reserves in order to use up their percentage depletion limitation.

An argument for repeal of the anti-transfer rules is that by expanding the amount of oil and gas eligible for percentage depletion, the tax Code will provide a more powerful incentive for production, and may prevent the abandonment of wells that otherwise would be permanently closed. Oil and gas exploration activities also would be expected to increase as a result.

An argument against repeal of the anti-transfer rules is that integrated producers would be able to benefit indirectly from percentage depletion by selling reserves to independents. Repeal of the anti-transfer rules will not encourage exploration to the extent that transferred reserves were already discovered as of the date of enactment.

Repeal of 50-percent of net income limitation

The percentage depletion deduction for an oil or gas well is computed as 15 percent of gross income from the well, but limited to 50 percent of taxable income from the property. The 50-percent limitation prevents the percentage depletion deduction from reducing the taxpayer's effective rate of tax on oil and gas income by more than one-half.

The 50-percent limitation has been criticized for causing perverse incentives. Percentage depletion actually provides the largest amount of subsidy to low cost producers, who would produce even without percentage depletion deductions, and the smallest amount

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[16] The minimum tax rules applicable to IDCs also would apply to these costs.

of subsidy to high cost producers. This is the case because high cost producers have little or no net income from their properties.

Moreover, producers subject to the 50-percent limitation actually may be discouraged from engaging in exploration and development activities since the cost of such activity is, in effect, nondeductible. This situation arises because each dollar of deductible exploration expense reduces the percentage depletion deduction by a dollar for a taxpayer at the 50-percent limit.

Others argue that the 50-percent limitation should be retained to prevent oil and gas producers from sheltering all of their income from tax. The ability of certain upper income individuals to avoid paying tax as a result of percentage depletion may create perceptions of unfairness, and may reduce voluntary compliance with the tax Code. In response it is argued that the alternative minimum tax enacted in 1986 and the 65 percent of taxable income limitation on percentage depletion deductions are sufficient to prevent excessive tax avoidance.

Change in rate of percentage depletion

Under the bill, the rate of percentage depletion for oil and gas would be increased from 15 percent to 30 percent as the average annual removal price of oil falls from $20 to $10 per barrel. The effect is to increase the rate of percentage depletion when the income of domestic producers falls due to declining world oil prices.

An argument in favor of a variable rate of percentage depletion is that it would tend to stabilize the income of oil and gas producers. This provision is similar to certain farm stabilization programs which increase payments to farmers when farm income falls as a result of oversupply.

An argument against a variable rate of percentage depletion is that it would provide little or no benefit to many of the oil and gas producers hardest hit by falling petroleum prices: those producers with net operating losses. Additional depletion deductions have no immediate value to producers that have no income tax liability.

Treatment of geological, geophysical and surface casing costs

Under present law lease acquisition and geological and geophysical costs (incurred with respect to successful wells) are recovered through depletion deductions. The cost of casing (both surface and production casing) and other tangible property used in exploratory and development drilling is recovered through depreciation deductions under the general rules applicable to plant and equipment (accelerated cost recovery system). By contrast, intangible drilling costs, such as labor and materials are expensed (except for integrated producers). Under S. 233, geological and geophysical ("G&G") and surface casing costs would be eligible for the more rapid cost recovery rules applicable to intangible drilling costs.

An argument against special treatment of G&G and surface casing costs is that it would favor the oil and gas industry relative to other sectors of the economy. The rules applicable to manufacturers require that most direct and indirect costs of production be capitalized (i.e., the full absorption method). Construction companies also must capitalize most direct and indirect costs of construction. In addition, surface casing already is eligible for accelerated

depreciation deductions. Expensing treatment would provide more favorable depreciation rules for oil and gas property than is available for equipment used in other industries and in agriculture.

An argument in favor of expensing G&G costs is that geological analysis and exploratory drilling are to some extent substitutable activities in the search for oil and gas properties. Present law may encourage too much drilling relative to geological investigation due to the less favorable tax treatment of G&G costs.

Repeal of recapture rule

Under the Tax Reform Act of 1986, gain from the sale of oil, gas, and geothermal property attributable to deductions for intangible drilling costs and depletion allowances are treated as ordinary income rather than capital gain. Since ordinary income and capital gains are taxed at the same rate after 1987, the effect of the recapture rule is to prevent recapture income from being sheltered by capital losses for taxpayers with net capital losses (or capital loss carryforwards).

Under the 1986 Act, the recapture rules for oil and gas property were made more similar to the rules applicable to depreciable property. Under S. 233, oil and gas property would be accorded more favorable recapture treatment than depreciable property—treatment that actually would be more beneficial to the taxpayer than the rules in existence before the 1986 Act.

As a result of the sharp decline in oil prices since 1985, many producers have incurred large capital losses on oil and gas property. Absent relief from the present recapture rule, these producers may not be able to utilize these capital losses in the near future when cashflow considerations are of great importance.

An argument against repeal of recapture for oil and gas property is that it would favor the oil and gas industry relative to other sectors of the economy such as agriculture and manufacturing.

2. S. 255—Senators Boren and Bingaman

Repeal of Crude Oil Windfall Profit Tax

Present Law

Present law imposes an excise tax (the crude oil windfall profit tax) on the windfall profit element of the price of domestically produced crude oil when it is removed from the premises on which it was produced. Generally, the windfall profit element is defined as the excess of the sale price over the sum of the adjusted base price plus the applicable State severance tax adjustment. The windfall profit element may not exceed 90 percent of net income attributable to a barrel of crude oil.

The tax rates applicable to taxable crude oil are as follows:

Category of Oil	Tax rate (percent)	Estimated Base Price [1] (dollars per barrel)
Tier-1 Oil (Oil Not in Tiers 1 or 2)		
Integrated producer	70	$18.49
Independent producer	50	19.07
Tier-2 Oil (Stripper and Petroleum Reserve Oil)		
Integrated producer	60	20.89
Independent producer	30	NA
Tier-3 Oil		
Newly discovered oil	[2] 22.5	27.59
Incremental tertiary oil	30	27.13
Heavy oil	30	23.11

[1] Estimate for fourth quarter of 1986 based on *SOI Bulletin* (Summer 1986). The estimated base price for tier-1 oil excludes North Slope oil.

[2] Phases down to 20 percent in 1988 and 15 percent in 1989 and subsequent years.

Independent producer stripper well oil is exempt from the tax. Additionally, crude oil from a qualified governmental or a qualified charitable interest, certain front-end oil, certain Indian oil, certain Alaskan oil and, in the case of qualified royalty owners, up to three barrels per day of royalty production, are exempt from the tax.

The windfall profit tax is scheduled to phase out over a 33-month period, beginning after December 31, 1987, if the cumulative revenue raised by the tax reaches $227.3 billion net of income tax offset, but in any event beginning no later than January 1991. As of September 1985, $76.7 billion of windfall profit tax had been collected (before reduction for income tax offset).

During the 99th Congress, the Senate approved legislation that would have repealed the windfall profit tax, effective October 1, 1987. The provision was an amendment to H.J. Res. 668, a bill to increase the Federal debt limit. No further action was taken on the bill.

Explanation of the Bill

The bill would repeal the crude oil windfall profit tax, effective for oil removed from the premises after the date of enactment.

Effective Date

The bill is effective for oil removed from the premises after the date of enactment.

Issues

Revenues

One of the main arguments in favor of repealing the windfall profit tax is that at present price levels, the tax raises little or no revenue yet producers must nevertheless incur the burdensome recordkeeping expenses associated with the tax. Based on the Congressional Budget Office's most recent forecast of petroleum prices, the windfall profit tax will raise little or no revenue over the next five years.

In response it is argued that the price of oil is extremely volatile and that past attempts to predict future oil prices have been fraught with error. Forecasters failed to foresee the rapid rise in petroleum prices following the October 1973 war, and the rapid fall in petroleum prices in 1986. The unpredictable nature of oil prices suggests that revenue estimates of the windfall profit tax should be viewed with caution. An unforeseen crisis in the Middle East could send the world market price of oil soaring: in this event repeal of the tax could result in a substantial revenue loss.

Effect on exploration and production

Another argument for repealing the windfall profit tax is that it discourages exploration and production of domestic oil. The windfall profit tax is in effect a sales tax on domestic crude oil which cannot be passed on by the producer since the price of petroleum is set by foreign producers who are not subject to the tax. As a result of the tax, high cost oil may not be produced, and exploration activities may be reduced. The effects of the windfall profit tax may be offset by the percentage depletion allowance which is, in effect, a tax subsidy based on sales (i.e., a negative excise tax). However, it is hard to justify a tax system which simultaneously encourages and discourages crude oil production.

In response it is argued that the windfall profit tax minimizes adverse effects on exploration and development by setting higher base prices and lower tax rates for newly discovered, incremental tertiary, heavy, and stripper well oil.

Oil price decontrol

In April of 1979, the Carter Administration announced that it would use its discretionary authority over oil prices to phase out price controls between June 1, 1979 and September 30, 1981. Members of Congress who favored price controls did not seek legislation against decontrol in return for Administration support for a tax on a portion of the profits attributable to decontrol. The Crude Oil Windfall Profit Tax Act of 1980 is a result of this compromise.

Some argue that repeal of the Crude Oil Windfall Profit Tax Act would breach the compromise reached in 1980. Others argue that the inflation-adjusted price of oil is now less than half of what it was when the Crude Oil Windfall Profit Tax Act was enacted. This change in circumstances, it is argued, justifies major change or repeal of the Act.

3. S. 302—Senators Boren and Bingaman

Excise Tax on Imported Crude Oil and Petroleum Products

Present Law

Superfund taxes

Excise taxes are imposed on petroleum and certain chemicals to fund the Hazardous Substance Response Trust Fund ("Superfund").

Petroleum tax

A tax of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products is imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

Domestic crude oil subject to tax includes crude oil condensate and natural gasoline, but not other natural gas liquids. Taxable crude oil does not include oil used for extraction purposes on the premises from which it was produced, or synthetic petroleum (e.g., shale oil, liquids from coal, tar sands, biomass), or refined oil.

Petroleum products which are subject to tax upon import include crude oil, crude oil condensate, natural and refined gasoline, refined and residual oil, and any other hydrocarbon product derived from crude oil or natural gasoline which enters the United States in liquid form. The term "United States" is defined to mean the 50 States, the District of Columbia, Puerto Rico, the Northern Mariana Islands, the Trust Territory of the Pacific Islands, and any possession of the United States, as well as the Outer Continental Shelf and foreign trade zones located within the United States.

The petroleum tax generally expires on December 31, 1991. The tax would terminate earlier than that date if cumulative Superfund receipts during the reauthorization period equal or exceed $6.65 billion, and under certain other conditions.

Tax on feedstock chemicals

The tax on feedstock chemicals applies to the sale or use of 42 specified organic and inorganic chemicals ("feedstock chemicals") by the manufacturer, producer, or importer. These chemicals generally are hazardous substances, or may create hazardous products (or wastes) when used. The tax rates range from 22 cents to $4.87 per ton of the chemical concerned. (A special rate applies to xylene to compensate for refunds of tax previously paid with respect to xylene).

The tax on feedstock chemicals expires on December 31, 1991, or earlier, under the same circumstances as the tax on petroleum.

Import fee authority

Under the Trade Expansion Act of 1962, the President can impose oil import fees or import quotas if he finds that imports threaten the nation's security. Congress may roll back such fees by passing a joint resolution of disapproval. However, this resolution can be vetoed by the President, in which case the fees he imposed would continue in effect unless the President's veto is overridden by a two-thirds vote of both Houses of Congress. These procedures for Congressional vetoes and overrides were specified by the Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223).

Under an exemption from the General Agreement on Tariffs and Trade (GATT), a tariff imposed on national security grounds is not a violation of trade agreements. Consequently, enactment of a tariff on imported petroleum for legitimate national security reasons would not result in the imposition of GATT-authorized countervailing duties or other trade penalties.

The presidential import fee authority was used, to various extents, by Presidents Nixon, Ford, and Carter. President Nixon imposed import license fees of 21 cents per barrel for crude oil and 63 cents on refined products in 1973 (this differential was intended to encourage domestic refining). President Ford imposed an additional $2 per barrel crude oil import fee in 1975, but lifted the fee early in 1976. President Carter raised the possibility of an import fee in 1977 and again in 1979, in response to which Congress adopted the veto and override provisions contained in the Crude Oil Windfall Profit Tax Act. (Both the Ford import fee and the original Carter proposal were intended to encourage action on broader energy proposals.) President Carter actually imposed a $4.62 per barrel import fee in 1980, with allocation rules that effectively converted the fee into a 10-cents-per-gallon gasoline tax. However, a resolution of disapproval was passed by the Congress, and President Carter's veto of that resolution was overridden.

Tariff on imported petroleum

Tariffs are imposed on various categories of articles that are imported into the customs territory of the United States (including the 50 states, the District of Columbia, and Puerto Rico). The tariffs generally are imposed at a uniform rate for imports from most noncommunist countries, with separate, higher rates imposed on imports from certain communist nations. Preferential treatment applies to certain imports from developing countries, specified Caribbean basin nations, and Israel. Imports from U.S. insular possessions, where the imported product is not comprised primarily of foreign materials, may be made duty-free. Tariffs are imposed pursuant to the Tariff Act of 1930 (19 U.S.C. sec. 1202 *et seq.*), and generally are subject to GATT limitations.

At present, a tariff of 0.125 cent per gallon is imposed on crude petroleum, topped crude petroleum, shale oil, and distillate and residual fuel oils derived from petroleum, with low density (under 25 degrees A.P.I.). For substances with higher densities (testing 25 degrees A.P.I. or more), the tariff is 0.25 cent per gallon.[17] (Imports

[17] Degrees API equals 141.5 divided by specific gravity, less 131.5.

from certain communist countries are subject to a 0.5-cent-per-gallon tariff, regardless of density.) A 1.25-cents-per-gallon tariff (2.5 cents, for certain communist countries) also is imposed on certain motor fuels and a 0.25-cent-per-gallon tariff (0.5 cent, for certain communist countries) on petroleum-derived kerosene and napthas (except motor fuels). Natural gas, together with methane, ethane, propane, butane, and mixtures thereof may be imported tariff-free. Certain Canadian petroleum also may be admitted tariff-free, subject to an exchange agreement allowing like treatment for an equivalent amount of U.S. petroleum imported into Canada.

Explanation of the Bill

Imposition of tax

This bill would impose an excise tax on crude oil or refined petroleum products that are imported into the United States if the prices of the petroleum products are below a predetermined price (as described below). The tax would be imposed on the first sale of the crude oil or refined product within the United States; if the crude oil or refined product is used before tax has been imposed, the tax would be imposed on that use. The tax would be paid by the seller of the taxable product (or in the case of use, by the user of the product).

All crude oil (defined as including crude oil condensates and natural gasoline but not including any crude oil produced from a well located in the United States) would be subject to the tax. Refined petroleum products subject to the tax would include refined oil, fuels, and chemical feedstocks which are refined or derived from non-U.S. produced crude oil.

Amount of tax

For the above described petroleum products, the amount of tax per barrel [18] for a weekly period would equal the excess of (1) $18 over (2) the average international price of crude oil for the preceding 4-week period. The determination of the average international price of crude oil for a 4-week period would be made by the Secretary of Energy (or his delegate) and published in the Weekly Petroleum Status Report. If the average international price of crude oil for any 4-week period equals or exceeds $18, then no tax is imposed for the week immediately following the 4-week period. In the case of a fraction of a barrel, the amount of tax imposed is the same fraction of the amount that would be imposed on a whole barrel.

Exception to the tax

An exception to the tax would be provided for petroleum products that are sold for export, or for resale to a second purchaser for export. The tax would be reimposed on such transactions unless, within 6 months after the sale, the seller receives proof that the petroleum product actually has been exported. For purposes of this exception, the term "export" includes shipment to a United States possession.

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[18] A barrel is defined as 42 United States gallons.

Procedure and administration

Procedures, tax returns, and penalties with respect to the tax would be equivalent to those applicable to the crude oil windfall profit tax, except as provided by Treasury regulations where such treatment would be inappropriate.[19] Persons subject to the tax also would be required to register with the Treasury Department at such time and in such manner as the Secretary may prescribe. (As indicated in footnote 19, below, excise taxes normally are collected on a quarterly basis. As the tax under this bill would be imposed on a weekly basis, regulations would have to be issued to coordinate this tax with excise tax requirements in general.)

Deductibility against income tax

The tax imposed by the bill would be fully deductible against Federal income taxes.

Effective Date

The provisions of the bill would apply with respect to sales of imported crude oil and refined petroleum products in calendar quarters beginning more than 30 days after the date of enactment of this Act. It is unclear whether imported oil which has been sold in the United States before the effective date but which is held in inventory for resale or is not otherwise subject to use until after the effective date would be subject to the tax.

Issues

a. Energy policy

In general

A tax on the sale or use of imported petroleum is economically equivalent to an increase in petroleum tariffs. Both would raise the domestic price of petroleum above the world market price by the amount of the tax or tariff.[20] This would influence both the domestic demand and supply for petroleum.

Domestic consumers confronted with higher petroleum prices will over time reduce petroleum consumption. Demand reduction will occur as consumers shift to alternative fuels, improve energy efficiency, and curtail consumption of goods and services produced from petroleum.

A higher domestic oil price will increase profits of domestic producers and boost production of petroleum and petroleum substitutes (such as natural gas and synthetic fuels).

Both the supply and demand effects of an oil import tax would reduce the share of petroleum imports in the domestic market.

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[19] Except as otherwise provided in regulations, the windfall profit tax is required to be withheld by the first purchaser of domestic crude oil from the price paid for the oil; if withholding is not required, the tax is paid by the seller. The purchaser also may elect to have the operator assume its responsibilities under certain cases. Returns are filed on a quarterly basis, with semimonthly deposits being required for major refiners and retailers and monthly deposits (not later than 45 days after the close of the month) for most other purchasers.

[20] At a sufficiently high tariff rate, imports would be eliminated and the domestic price of petroleum might rise by less than the full amount of the tariff.

Energy security

The sharp increases in the world price of oil in 1973-74 and 1979-80 have raised concerns about the vulnerability of the U.S. economy to world oil market shocks. Some argue for a tax on imported petroleum to reduce import dependence.

Others argue that reducing the share of imports in the U.S. petroleum market will not necessarily reduce U.S. vulnerability to oil price shocks. Since oil is traded in a world market, a shortage which pushes up the world price immediately increases domestic price. Price controls, such as existed before 1980, can be used to dampen price shocks; however, shortages may arise. As an alternative, the Strategic Petroleum Reserve (SPR), which now contains a 100-day supply of imports, could be used to drive down the price of petroleum in the event of a world shortage.

Since petroleum reserves are finite, policies which encourage substitution of domestic for imported petroleum may reduce import dependence in the near-term, while increasing dependence in the future.

High cost producers

Some attribute the precipitous decline in the price of oil in 1986 to an intentional flooding of the world market by Saudi Arabia and other OPEC members. It is argued that OPEC intends to drive high cost producers, such as tertiary recovery and heavy oil producers, out of the market. This might allow OPEC to raise prices sharply in the future.

An oil import tax could be used to protect high cost domestic petroleum producers from the decline in world oil prices. However, this approach would be expensive for consumers since both high and low cost producers would be subsidized by an import tax. A less costly alternative would be to target financial assistance to high cost producers, although this would be complex to administer.

Government intervention in the oil market may be unnecessary if the market anticipates a rebound in the world market price of oil. If this is anticipated, then high cost producers may retain production capability until prices rise, or their reserves may be sold to investors who anticipate a future price increase.

Energy market stability

S. 302 would stabilize the domestic price of oil at a floor of $18 per barrel by taxing imports by the excess of $18 over the world market price. This would in effect provide a "parity" price of $18 per barrel for oil, much like the price supports for certain agricultural commodities. Oil price support proposals are motivated in part by a desire to avoid the costs to the economy of rapid swings in the world market price of petroleum. Sharp price increases in the past have caused economic recessions and inflation, while the rapid price drop last year has caused an exodus of skilled labor and capital from the oil and gas industry.

A side effect of a variable import tax is that it would tend to destabilize the world petroleum market. This type of tax raises the domestic price of petroleum—encouraging production and discouraging consumption—just when there is a glut in the world market.

This adds further downward pressure on the world market price during periods when it already is depressed. The more the world market price falls, the larger the import tax, which causes the world market price to fall further. Such a destabilizing policy might have adverse foreign policy repercussions, and could make it more difficult for the major petroleum consuming countries to coordinate energy policy.

b. Industry impacts

Industrial use of petroleum products

Industrial customers accounted for over 25 percent of petroleum use in the United States in 1984. A petroleum import tax would increase production costs for industries that use petroleum products as fuels or feedstocks. Industries that use natural gas also would confront higher production costs to the extent that the price of natural gas rises in response to a tax on petroleum. In addition, manufacturers that use materials (e.g., plastics) and services (e.g., electricity) produced from petroleum would experience increased production costs. These cost increases are part of the way in which a tax on imported oil encourages conservation.

An oil import tax would reduce the competitiveness of energy intensive industries that compete with foreign producers in the United States or in foreign markets. Since foreign manufacturers who use petroleum or petroleum products do not pay the import tax they have an advantage over domestic manufacturers. Similarly, U.S. export goods made from petroleum or petroleum products are disadvantaged relative to foreign-produced goods.

The effect of a $5 per barrel petroleum import tax on the manufacturing sector can be estimated from the energy intensity of domestic industries. A $5 per barrel tax is chosen for the sake of example only: at present market prices, the tax imposed by S. 302 would be much less than this amount. Table 1 shows the quantity of petroleum products directly consumed in the major industry groups relative to the value of shipments. The industries with the most intensive use of petroleum products are: paper; stone, clay, and glass; chemicals; and primary metals. The tax burden imposed by a $5 per barrel petroleum tax as a percent of the value of shipments is: 0.4 percent in paper; 0.1 percent in stone, clay, and glass; 0.1 percent in chemicals; and 0.08 percent in primary metals. These estimates understate the total burden since indirect petroleum consumption (e.g., electricity), and the effect of a petroleum tax on competing fuels (e.g., natural gas) is not taken into account.

Table 1.—Industrial Use of Petroleum Products, 1980

Industry group	Petroleum products used (Trillion Btu)	Value of shipments (Billion dollars)	Petroleum use per dollar of shipments (Btu/$)	Import tax as a percent of shipments (%)
Food and kindred products	108.3	256.2	422.9	0.03
Tobacco products	2.8	12.2	232.0	0.02
Textile mill products	42.3	47.3	896.0	0.07
Apparel and textile products	3.7	45.8	81.5	0.01
Lumber and wood products	29.9	47.1	634.3	0.05
Furniture and fixtures	48	22.3	216.5	0.02
Paper and allied products	366.7	72.8	5,037.0	0.40
Printing and publishing	6.0	69.5	86.2	0.01
Chemical and allied products	193.7	162.5	1,192.1	0.10
Petroleum and coal products	59.7	198.7	300.5	0.02
Rubber and plastic products	28.3	47.3	597.4	0.05
Leather and leather products	4.5	9.8	462.3	0.04
Stone, clay and glass	56.3	46.1	1,220.6	0.10
Primary metal industries	136.6	133.9	1,020.0	0.08
Fabricated metal products	26.0	116.2	223.5	0.02
Machinery, except electrical	23.4	180.7	129.6	0.01
Electric equipment	18.3	128.6	142.4	0.01
Transportation equipment	35.4	186.5	189.9	0.02
Instruments, related products	8.4	44.1	190.8	0.02
Miscellaneous manufacturing	5.4	25.0	217.8	0.02
Total, all industries	1,160.7	1,852.7	626.5	0.05

Source: U.S. Bureau of the Census, *Census of Manufacturing,* 1982.

Increasing the Federal excise tax on gasoline and diesel fuels has been suggested as an alternative to a petroleum import tax because it has a smaller impact on international competitiveness.

Petroleum refining

A tax on imported crude oil would increase refiner acquisition costs above the world market price, which would reduce the export competitiveness of U.S. refiners. Profits from exports of refined products would be reduced unless domestic refiners are compensated for higher petroleum acquisition costs.

Banking

The decline in the world market price of oil has reduced the value of oil industry assets and the value of land located in oil producing regions of the countries. Loans based on the value of oil industry assets are threatened by the recent decline in petroleum prices. As a result, banks and savings and loan institutions with large portfolios of energy-related loans may be confronted with reduced income and possible insolvency. One argument for a tax on imported oil is that it would reduce the failure rate of banks with significant domestic energy loans. This would reduce Federal government outlays to the extent that these lending institutions are Federally insured.

Others argue that present law addresses the problem of bank failures at a lower cost to taxpayers than would be the case under an oil import tax. Under present law, Federal expenditures are targeted to financially troubled lending institutions. An oil import tax would benefit all lending institutions with domestic energy loans, regardless of risk of loss or insolvency, and the cost would in large part be borne by energy consumers.

A number of U.S. banks have made large loans to Mexico, Venezuela, and other oil exporting countries. A tax on imported petroleum could reduce the ability of oil exporting countries to service their debts to U.S. banks. A petroleum import tax would harm banks with loans to oil exporting countries while helping banks with domestic energy loans. Thus, a tax on imported petroleum may not be beneficial to the U.S. banking industry as a whole.

c. Income distribution of tax burden

A tax on imported petroleum may be passed through to individuals in the form of (1) higher prices for products manufactured from petroleum, (2) lower wages paid by petroleum-using firms, (3) reduced dividends and distributions from petroleum-using firms, and (4) higher wage, dividend, and royalty income from petroleum production and related activities. Since petroleum is used in virtually all sectors of the economy, it is difficult if not impossible to trace the full effect of a tax on imported petroleum on prices. Moreover, a tax on imported petroleum may result in higher prices of petroleum substitutes such as natural gas. These price increases also redistribute domestic income.

One way to analyze the distributional impact of a petroleum tax is to limit consideration to direct household consumption of refined petroleum products. Table 2 shows that low-income households spend a much larger portion of income on refined products than high-income households. Households with income below $5,000 in 1980-81 spent 52.8 percent of income on refined products, while households with income over $50,000 devoted only 3.1 percent of

income to refined products. As a result of this consumption pattern, the burden of a $5 per barrel tax on petroleum would fall relatively more heavily on low income households. Such a tax would amount to a 5.0-percent tax on the income of households in the below-$5,000 income class, compared to a 0.3-percent tax on the income of households in the above-$50,000 income class.[21]

Table 2.—Income Distribution of Petroleum Consumption, 1980–1981

Income class (dollars)	Household petroleum [1] expenditures as a percent of income (percent)	Household petroleum consumption per dollar of income (Btu/dollar)	Import tax [2] as percent of income (percent)
0–5,000	52.8	53,001	5.0
5–10,000	11.5	11,454	1.1
10–20,000	8.8	8,720	0.8
20–30,000	6.9	6,802	0.6
30–40,000	5.8	5,742	0.5
40–50,000	4.8	4,777	0.5
50,000 +	3.1	3,034	0.3
Total	7.9	7,840	0.7

[1] Includes home heating oil, liquefied petroleum gas, gasoline, diesel fuel, kerosene, and motor oil.

[2] Assumes $5 per barrel tax on imported crude oil and refined products with no exemptions.

Source: U.S. Bureau of the Census, *Consumer Expenditure Survey.*

d. Regional impacts

A tax on imported petroleum would have varying effects on regional income as a result of differences in petroleum production and consumption in different parts of the country. Regions that derive most of their energy from coal and nuclear power would benefit relative to regions that are dependent on petroleum. Petroleum producing areas of the country generally would benefit relative to areas without petroleum reserves. However, to the extent that shareholders of petroleum companies reside outside of producing regions, some of the benefits of higher oil prices could accrue in energy-consuming regions of the country. The adverse effect of an oil import tax on the competitiveness of petroleum-intensive manufacturers would be felt by the owners and employees of these companies in all regions of the country.

[21] This analysis considers only direct petroleum consumption by households and assumes that a petroleum tax is passed through to consumers in the form of higher prices for refined products.

One way to assess the regional impact of an oil import tax is to compare the consumption of petroleum products in different regions of the country.[22]

Table 3.—Regional Distribution of Petroleum Consumption,[1] 1983

[Thousand Btu's per dollar of personal income] [2]

Region [3]	Residential	Transportation	Industrial and commercial	Total
New England	1.6	4.9	4.4	10.9
Middle Atlantic	0.9	4.7	3.2	8.8
Eastern North Central	0.4	5.6	2.7	8.7
Western North Central	0.7	7.3	3.5	11.4
South Atlantic	0.5	7.5	2.8	10.7
Eastern South Central	0.3	9.1	3.2	12.6
Western South Central	0.2	9.9	10.2	20.2
Mountain	0.3	8.3	3.0	11.6
Pacific Coast	0.1	7.1	2.1	9.3
U.S. average	0.5	6.8	3.7	11.0

[1] Includes road oil, aviation gas, distillate fuel, kerosene, liquified petroleum gas, lubricants, motor gasoline, residual fuel, and other petroleum products.

[2] Personal income is defined as income from all sources before tax, excluding military employees stationed abroad.

[3] New England includes CT, ME, MA, NH, RI, VT; Middle Atlantic includes NJ, NY, PA; Eastern North Central includes IL, IN, MI, OH, WI; Western North Central includes IA, KS, MN, MO, NE, ND, SD; South Atlantic includes DE, FL, GA, MD, DC, NC, SC, VA, WV; Eastern South Central includes AL, KY, MS, TN; Western South Central includes AR, LA, OK, TX; Mountain includes AZ, CO, ID, MT, NV, NM, UT, WY; and Pacific Coast includes CA, OR, WA

Source: U.S. Dept. of Energy, Energy Information Agency, *State Energy Data Survey,* 1983

Table 3 shows that the high rate of petroleum consumption in the southwest is due to transportation and industrial use of petroleum, rather than residential use. Residential petroleum consumption is less than half the national average in the west south central and pacific coast states, and more than three times the national average in New England. This is due primarily to the greater consumption of home heating oil in the northeastern region of the United States. Consequently, an oil import tax would have a larger impact on residential consumers in the northeast compared to consumers in the southwest.

In contrast to residential petroleum use, industrial and commercial use of petroleum is three times the national average in the southwestern states. Transportation use of petroleum, primarily

[22] This analysis assumes implicitly that the burden of a petroleum tax on an industrial user falls in the region of the country where the use occurs. Also, this analysis does not take into account the effect of higher petroleum prices on the income from petroleum producing and related activities, nor the effect on prices of competing fuels such as natural gas. For a discussion of issues involved in modeling regional effects of energy price changes see: Joeseph P. Kalt and Robert A. Leone, "A Model of Regional Income Accrual Under Energy Price Decontrol," Harvard Institute for Economic Research, Discussion Paper 1041 (February 1984).

gasoline, is almost 50 percent above the national average in the southwest versus 30 percent below average in New England and the middle Atlantic States.

While the oil-producing States would benefit substantially from higher oil prices, the data in Table 3 show that part of this benefit is likely to be offset because these States spend a much higher proportion of personal income on petroleum products. To determine the net regional effect of a petroleum import tax requires tracing the increase in oil-related income to the ultimate recipients of this income, and tracing the increase in the price of products derived from petroleum to the consumers of these products.

e. International relations

The effect of a tax on petroleum imports would be to raise the domestic price of petroleum relative to the world market price. This relative price shift occurs either because the domestic price of petroleum increases, or because the world market price falls. In the former case, the tax merely distributes income from domestic consumers to domestic producers and the government. In the latter case, the tariff has no affect on the domestic market; instead, the effect of the tariff is to transfer wealth from countries that are net petroleum exporters to countries that are net importers, such as the United States.

An importing country may be able to shift the burden of an import tax to exporting countries in situations where it consumes a large portion of world production, and its demand for the product is relatively sensitive to price changes. Some argue that a U.S. tax on imported oil is desirable because a portion of the tax would in effect be paid by exporting countries in the form of a reduced world market price of oil. Importers such as Japan and Europe would benefit from a decline in the world price of oil resulting from a U.S. import tax.

To the extent that a U.S. import tax lowers the world market price of petroleum, countries that are net petroleum exporters would experience a decline in export income. This could reduce the ability of countries such as Mexico and Venezuela to service their debts to U.S. banks, and strain U.S. relations with these countries and other oil exporting allies.

f. Revenue issues

An oil import tax has been advocated by some as a desirable source of revenue to reduce the Federal budget deficit. However, S. 302 would impose a floating rate of tax on imported petroleum, depending on the world price of oil, rather than a specific dollar amount of tax per barrel. Thus, the amount of revenue raised would depend on the future price of oil in the world market. Given the tremendous uncertainty about the future course of world oil prices, any revenue estimate must be viewed as subject to a large margin of error. If Congress wishes to use a petroleum import tax to achieve a specific revenue target, the rate of tax probably should be set equal to a fixed amount per barrel to avoid revenue fluctuations due to unanticipated swings in the world price of petroleum.

Another criticism of using an oil import tax as a revenue raiser is that such a tax would raise the price of oil to all consumers, but tax would only be collected on 40 percent of petroleum consumed—the amount that is imported.[23] Thus it is argued that a tax on petroleum designed to raise revenue should be imposed on both domestic and imported oil.

g. Tax administration

Under S. 302, the rate of tax on imported oil would be adjusted on a weekly basis, based on the average international price of crude oil in the preceding four-week period. The potentially frequent change in tax rate could cause administrative difficulties as well as tax avoidance. For example, a refiner may delay withdrawals from crude oil inventory if it is clear that the rate of tax in the next week will be less than the prevailing tax rate. Similarly, refinery runs might be accelerated during weeks in which the tax rate dips temporarily. Tax motivated shifting in refinery production could interfere with operating efficiency. Also, it may be difficult for the IRS to determine the week in which oil is used, and whether previously taxed versus untaxed oil is consumed at any point in time.

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[23] The price of natural gas and other petroleum substitutes also would increase.

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