[JOINT COMMITTEE PRINT]

DESCRIPTION OF H.R. 3919, H.R. 3421, AND H.R. 3474

RELATING TO

WINDFALL PROFIT TAXES

SCHEDULED FOR HEARINGS

BY THE

COMMITTEE ON WAYS AND MEANS

BEGINNING MAY 9, 1979

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

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I. INTRODUCTION

The proposal for a windfall profit tax has been scheduled for a hearing beginning on May 9, 1979, by the Committee on Ways and Means.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the proposal. The description indicates present law, its background, an explanation of the proposal, its effective date, and its estimated revenue effect.

The Administration's proposed windfall profit tax is embodied in a bill, H.R. 3919, introduced by Chairman Ullman. The Chairman's bill generally reflects the Administration's proposal but contains some technical changes. In addition, the pamphlet contains a description of windfall profit tax bills introduced by Mr. Cotter (H.R. 3421) and Mr. Conable (H.R. 3474).

II. SUMMARY OF BILLS

A. H.R. 3919 (Mr. Ullman)

H.R. 3919 is substantially identical to the Administration's proposal for a windfall profit tax.

Under the Administration proposal and Chairman Ullman's bill, the windfall profit tax would operate as follows: Crude oil produced in the United States would be taxed in one of three tiers. The tier one tax rate would be 50 percent of the difference between the actual selling price of the oil and the current lower tier, or old oil, ceiling price (now just under $6 per barrel) adjusted for inflation. The tier two tax rate would equal 50 percent of the difference between the actual selling price and the current upper tier, or new oil, ceiling price (now $13 per barrel) adjusted for inflation. The tier three tax rate would equal 50 percent of the difference between the actual selling price and $16 per barrel, adjusted for inflation and quality differentials.

The tier one rate would apply to oil produced on a property below a statutory decline curve. The quantity of oil subject to the tier one tax rate would equal the average daily amount of oil produced on the property in the period October 1978-March 1979, reduced by 1.5 percent per month in 1979 and 2 percent per month thereafter. This decline rate would cause the tier one tax rate to be phased out after May 1983. Exempt from the tier one tax rate would be marginal properties (defined according to well depth and per well production in 1978), stripper properties, newly discovered oil, oil produced north of the Arctic Circle in Alaska, and incremental oil produced from tertiary recovery techniques.

The tier two tax rate would apply to marginal properties and oil produced on a property in excess of the amount indicated by the tier one decline curve. This tax rate would phase out between 1986 and 1990. Stripper oil, newly discovered oil, oil produced north of the Arctic Circle, and incremental tertiary recovery would be exempt from tier two.

The tier three tax rate would apply to all oil, other than oil produced north of the Arctic Circle, which is not subject to tax under either of the other tiers.

The tax would be a deductible business expense under the income tax. In addition, gross income for purposes of determining percentage depletion would be reduced by the amount of windfall profits subject to the tax.

The revenues from the windfall profit tax would be dedicated to an Energy Trust Fund which also would be established by the legislation. In general, the proposed Energy Trust Fund would be structured in a manner similar to other existing trust funds which receive specifically dedicated excise taxes, such as the Highway Trust Fund.

The tax would be effective as of January 1, 1980.

B. H.R. 3421

(Messrs. Cotter, Lederer, and Shannon)

The bill would impose an 85-percent excise tax on all profits resulting from crude oil price increases in excess of what producers could have received under the price control regulations which were in effect in March 1979. The oil subject to tax would be that which would have been subject to price controls under the price control regulations in effect in March 1979. The tax base would be equal to the difference between the actual selling price for the oil and the March 1979 controlled price for that oil, adjusted for inflation. Tax exemptions would be provided for newly discovered oil and for oil produced north of the Arctic Circle.

The tax would be effective on the first day of the first month beginning after enactment.

C. H.R. 3474

(Messrs. Conable, Vander Jagt, Franzel, Martin, Bafalis, and Gradison)

Under the bill, a 25-percent oil deregulation tax would be imposed on all crude oil price increases resulting from price control deregulation.

The tax generally would apply to the first sale of all domestically produced crude oil that would have been subject to price controls under March 1979 regulations. The tax would apply to the difference between the actual or constructive selling price of the oil, and the May 1979 controlled price for that oil, adjusted for inflation. Exceptions to the tax are provided, however, for Alaskan North Slope oil, stripper oil, "newly discovered oil," for production resulting from tertiary recovery processes, and for small producers.

A credit against the tax would be provided for qualifying energy investments in excess of a credit threshold.

The tax would apply to taxable crude oil removed from the premises between June 1, 1979, and September 30, 1981.

III. PRESENT LAW

A. Oil Pricing Provisions

1. Overview

Under present law, the price of domestic crude oil is regulated in accordance with the Emergency Petroleum Allocation Act of 1973 (Pub. L. 93–159), as amended by the Energy Policy and Conservation Act of 1975 (Pub. L. 94–163). Under these rules, approximately 70 percent of domestic oil production, or 6 million barrels per day, is subject to Federal price controls. (Oil produced on Alaska's North Slope, another 15 percent of the total, has a ceiling price well above its actual selling price.) Because the United States imports about 43 percent of its total oil supply, price-regulated oil represents about 40 percent of all oil consumed domestically.

The exact nature of the price controls is determined administratively, but until June 1979 there is a legislatively mandated ceiling on the average price of most oil (the legal composite price). Oil produced from stripper wells, *i.e.*, from properties where the average daily per well production is 10 barrels or less, is not subject to these ceilings (10 C.F.R. 212.54). In May 1979, the maximum legal average price will be $10.37 per barrel, and the actual average price will be about $9.40 per barrel.

Crude oil price controls are mandatory through May 31, 1979. After May 31, 1979, the legal composite price expires. From June 1, 1979 until September 30, 1981, the President has discretionary authority to set oil prices at any level. All Federal price control authority expires on September 30, 1981.

2. Oil classifications

Regulations administered by the Department of Energy (DOE) contain several classifications of oil. "Lower tier oil" is the amount of crude oil produced on a property which is equal to or less than the lower of the property's 1972 or 1975 production, which is called its "base production control level" (BPCL), adjusted for part of the natural decline in production that occurs in oil fields. Lower tier oil also is referred to as "old oil" or "first tier oil."

"Upper tier oil" is the amount of oil which is produced from a property in excess of its BPCL. This includes all production from a property which first began production after 1972. Upper tier oil also is referred to as "new oil" or "second tier oil."

a. Lower tier oil

Lower tier oil is subject to a ceiling price equal to the sum of: (1) the highest posted field price for that oil on May 15, 1973, (2) $1.35 per barrel, and (3) certain post-1975 increases intended to provide adjustments for inflation and to provide production incentives. The estimated May 1979 average ceiling price for a barrel of lower tier oil is $5.86. However, depending on quality and location, the price of any particular barrel may vary from the average by as much as $2 per barrel.

Lower tier oil represents about 36 percent of domestic production or 3 million barrels per day. This is approximately 21 percent of domestically consumed oil.

Lower tier oil generally is determined by computing a property's BPCL. A property's BPCL is the lesser of (1) the average monthly amount of all oil produced from the property [1] in 1972, or (2) the average monthly amount of lower tier oil produced from the property in 1975. A property's BPCL is adjusted downward, at 6-month intervals, by applying the historic rate of decline in production on that property between 1972 and 1975. Amounts equal to, or less than, a property's adjusted BPCL are classified as lower tier oil.

Once a property has produced an amount of oil above its adjusted BPCL, if it subsequently produces an amount of oil below the level of its adjusted BPCL, the difference between the reduced amount and the adjusted BPCL results in a "cumulative deficiency." Before a property's production in excess of its adjusted BPCL may be classified as upper tier oil, any amount of oil by which the property fell below its BPCL for all prior months, i.e., its cumulative deficiency, must be eliminated or "paid back."

b. Upper tier oil

Upper tier oil is the amount of oil produced from a property in excess of its adjusted BPCL, less the amount of any cumulative deficiency. It also includes all production, other than from stripper wells, from a property which first began production after 1972. The ceiling price for upper tier oil is the highest posted field price for uncontrolled oil on September 30, 1975, less $1.32 per barrel, plus certain post-1975 increases intended to offset inflation. The estimated average May 1979 ceiling price for a barrel of upper tier oil is $13.06.

Upper tier oil represents about 34 percent, or 3 million barrels per day, of domestic production. This is approximately 20 percent of domestically consumed oil.

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[1] For this purpose, a "property" is the right to produce domestic crude oil which arises from a lease or a fee interest. 10 C.F.R. sec. 212.72(a). A producer may treat as a separate property each separate and distinct producing reservoir subject to the same right to produce crude oil provided that the reservoir is recognized by the appropriate government regulatory authority as a producing formation that is separate and distinct from, and not in communication with, any other producing formation. FEA Ruling 1977–1. Thus, the price control definition of "property" may include smaller subdivisions than the income tax definition of that term contained in section 614 of the Code.

FIGURE 1

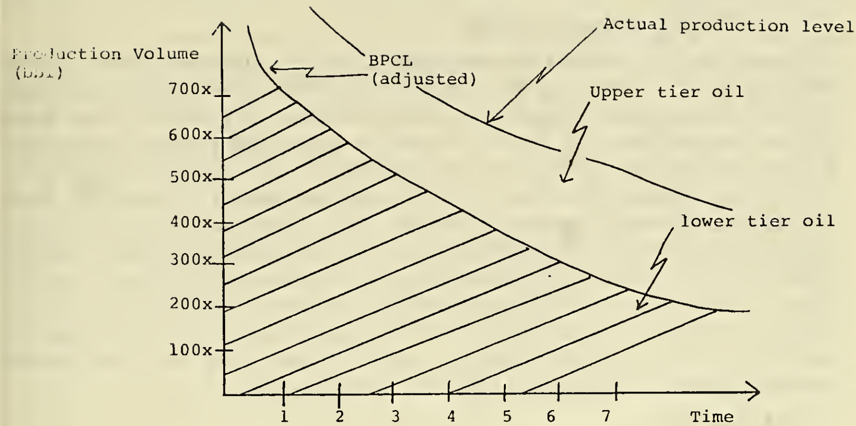

Figure 1 illustrates the classification of oil on a property into the lower and upper tiers under the price control regulations described above, which will be in effect until June 1, 1979. The BPCL in Figure 1 is based on property *A*'s actual decline in production for 1972–1975. If the volume of oil produced from that property during any month is equal to, or less than, the amount indicated by the adjusted BPCL for that month, the oil is classified as lower tier oil. Thus, for example, all production in the shaded area would be lower tier oil.

In the absence of a cumulative deficiency, if the production from property *A* for any month was greater than the amount indicated by the adjusted BPCL for that month, the excess would be classified as upper tier oil. Thus, any production which fell outside of the shaded area of Figure 1 would be entitled to the upper tier price, while that amount in the shaded area of the Figure would be entitled only to the lower tier price. For example, assume that the property's adjusted BPCL for May 1979 is 500X barrels per day, that there is no cumulative deficiency, and that 550X barrels actually are produced. The 500X barrels that are equal to the adjusted BPCL could be sold at that property's May 1979 price for lower tier oil; the 50X barrels produced in excess of the adjusted BPCL could be sold at the property's May 1979 price for upper tier oil.[2]

The purpose of establishing price control classifications using decline curves is to create a situation in which, for most properties, actual production is above the adjusted BPCL, so that any increases in production command the upper tier price. However, many properties have experienced declines in production since 1975 in excess of their 1972–75 decline rate, and actual production is below the adjusted BPCL. For these properties, especially those with a cumulative

[2] To meet any requirement relating to the volume of production for a specified period, each well on the property generally must have been maintained at the maximum feasible rate of production, which is consistent with recognized conservation practices, for that period, and must not have been curtailed significantly by reason of mechanical failure or other disruption in production.

deficiency, all or most additional oil production would command the lower tier price.

c. Other classifications

In addition to lower tier and upper tier oil, there are other classifications of oil. However, these other categories, in effect, are not subject to ceiling prices. These categories include: (1) oil produced from stripper properties, *i.e.*, those properties where the average daily production per well has been 10 barrels or less per day during any consecutive 12-month period after 1972, (2) any increased production from qualifying tertiary recovery projects, (3) Alaskan oil, and (4) any production from the Naval Petroleum Reserve. Although technically it is controlled as upper tier oil, Alaskan North Slope oil sells at a market price well below its ceiling price. Oil in these categories sells at the world price and accounts for about 30 percent, or 2.7 million barrels per day, of domestic production. In the aggregate, these categories represent about 17.5 percent of domestically consumed oil.

3. Entitlements

Present oil pricing rules establish an "entitlements" program which is intended generally to equalize the cost of oil to domestic refiners, regardless of the actual composition of their purchases of price-controlled and uncontrolled oil. Those U.S. refineries using more than the national average amount of price-controlled crude oil must buy "entitlements" from refineries using less than the national average. This purchase and sale of entitlements among refiners is intended to offset the advantage that otherwise would result for the refiners who can buy a disproportionate amount of price-controlled crude oil. The price of entitlements is set each month, based on price differences between lower tier, upper tier, and imported oil. Small refiners receive advantages under the entitlements program. (The "small refiner bias" is now about $2.00 per barrel for a refiner whose refinery runs are 10,000 barrels per day; however, DOE has proposed regulations to cut this figure approximately in half.)

Because importing crude oil gives the importer a right to an "entitlement" worth about $1.25 per barrel in December 1978, but importing a refined product generally does not, the entitlements program acts, in effect, as a subsidy to domestic refiners vis-a-vis foreign refiners.

4. Petroleum products

Prices of certain petroleum products, mainly gasoline, also are controlled, as are the marketing and distribution of these products. These controls are intended to ensure that the lower crude oil prices which result from price controls are passed through to consumers.

In addition, oil refiners are covered under the President's voluntary wage and price guidelines, and most of them have indicated their willingness to comply with the guidelines.

5. Recent administrative actions

a. Decline curve

Pursuant to a rule published by the Economic Regulatory Administration of DOE on April 12, 1979, a producer may elect to have the BPCL for any property be the average monthly production of lower tier oil from the property for the six-month period ending March 31, 1979 (44 Fed. Reg. 22010 (April 12, 1979)). For properties for which the producer elects to use this BPCL, the BPCL is reduced by 1.5 percent per month for 1979. The first such adjustment is effective as of June 1, 1979, but will be calculated as if the adjustments had become effective January 1, 1979. Thus, if an election is made for a property its BPCL is reduced by 9 percent, effective June 1, 1979 (six months x 1.5 percent).

Effective June 1, 1979, the rule eliminates all cumulative deficiencies.

As of January 1, 1980, the BPCL decline rate generally would be increased from 1.5 percent per month to 3 percent. The 3-percent decline factor applicable to 1980 and 1981 generally is available for all properties, including those electing not to use the updated BPCL in 1979.

The effect of this decline curve is gradually to phase out the lower tier of price controls so that relatively little lower tier oil (18 percent of the BPCL, which will be about one-fifth of what would have been lower tier oil under the current pricing system) will remain just before price controls expire on September 30, 1981.

b. Marginal properties

The rule published on April 12, 1979 also establishes oil produced from "marginal properties" as a new classification of oil generally eligible to receive upper tier prices. Specific properties, rather than individual wells, could qualify as being "marginal," depending upon the production level at different well depths. A property would qualify as being marginal if, for calendar year 1978, the average completion depth of all the property's producing wells and the average daily per well production from the property meet the following limits:

Average depth (in feet)	*Average daily production (in barrels)*
2,000, but less than 4,000	20 or less.
4,000, but less than 6,000	25 or less.
6,000, but less than 8,000	30 or less.
8,000 or more	35 or less.

On June 1, 1979, the BPCL for a marginal property is 20 percent of the average monthly production of lower tier oil from that property for the last six months of 1978, and the BPCL for marginal properties is reduced to zero as of January 1, 1980. Hence, as of June 1, 1979, all production on a marginal property in excess of 20 percent of 1978 production from the property may be sold at the upper tier price. As of January 1, 1980, all oil from marginal properties is eligible for the upper tier price.

Marginal properties are estimated to be about one-fourth of lower tier oil.

c. Qualified tertiary enhanced recovery projects

Under a DOE rule, first sales of incremental crude oil resulting from the implementation or expansion of a "qualified tertiary enhanced recovery project" are exempted from the otherwise applicable ceiling price limitations (49 Fed. Reg. 33689 (Aug. 1, 1978)). A qualified tertiary enhanced recovery project is one which is certified by DOE as being uneconomic at the otherwise applicable ceiling prices, and which involves one or more of several specified chemical, fluid, gaseous, or miscible recovery techniques (10 C.F.R. sec. 212.78(c), (d)).[3]

Generally, incremental tertiary production is the amount of production on a property, on which a qualifying project is being undertaken, in excess of an estimate of what production would have been without the tertiary project.

Specifically incremental crude oil, the price of which may exceed the ceiling price, is that amount (1) in the case of a new project, which is or will be produced in excess of the amount which could have been produced from the property or project through maximum feasible production from those ordinary recovery methods used prior to DOE certification, or (2) in the case of an expansion of an existing project, which is or will be produced as a result of the expansion over the amount which could have been produced through maximum feasible production from the pre-expansion recovery methods, or (3) in the case of a project which antedated the rule, which is or will be produced by continuing either the project or a high-cost phase of the project in excess of the amount which could have been produced through maximum feasible production from methods other than the tertiary method, or any phase thereof, which would be discontinued in the absence of a price incentive (10 C.F.R. sec. 212.78(c)).

The first DOE certification for tertiary enhanced recovery of crude oil pursuant to 10 C.F.R. sec. 212.78 was issued on April 16, 1979, to the Shell Oil Company. 44 Fed. Reg. 22505 (April 16, 1979). The average price of the oil that Shell recovered by using a steam injection process was $8.62 per barrel, and its production cost was $9.03 per barrel. The DOE certification exempts incremental production, in excess of a declining "Non-incremental Crude" schedule from the otherwise applicable ceiling price limitations (10 C.F.R. sec. 212.78(a)(1)).

d. Definition of "newly discovered oil"

Under regulations published on May 2, 1979, as of June 1, 1979, "newly discovered oil" is defined as crude oil which is sold after May 31, 1979, and which is produced from (1) an outer continental shelf area for which the lease was entered into on or after January 1, 1979, and from which there was no production in calendar year 1978, or (2) an onshore property from which no crude oil was produced in calendar year 1978. 44 Fed. Reg. 25828 (May 2, 1979). Oil produced from a property, as defined by DOE regulations, which previously had been developed but from which there was no production in calendar year 1978 also is treated as newly discovered oil. The determination of whether crude oil production from a particular property may be sold as newly discovered crude oil on or after June 1, 1979 is to be made by the producer, subject to DOE's possible review.

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[3] These methods include: (1) miscible fluid displacement, i.e., the pressurized injection of alcohol or gas so that the reservoir oil is displaced by the resulting mixture, (2) steam drive injection, (3) microemulsion, i.e., an augmented waterflooding technique, (4) in situ combustion, (5) polymer augmented waterflooding, (6) cyclic steam injection, (7) alkaline flooding, (8) carbonated waterflooding, (9) immiscible carbon dioxide displacement, and (10) any specific variation of any of these techniques (10 C.F.R. sec. 278(c)(1)–(10)).

Newly discovered oil may be sold at market prices on or after June 1, 1979.

e. Entitlements program

Under regulations published on May 2, 1979, the level of benefits received under the small refiners bias will be reduced beginning with refiners' crude oil runs on June 1, 1979. 44 Fed. Reg. 25621 (May 2, 1979). Initially, the per barrel value of the bias will be reduced to \$.96 at the 10,0000 barrels per day (B/D) crude run level, \$.53 per barrel at the 30,000 B/D level, \$.28 per barrel at the 50,000 B/D level, and \$.09 per barrel at the 100,000 B/D level. The bias will be calculated on an individual plant basis, and will phase out automatically with the expiration of the entitlements program and price control authority on September 30, 1981. The following table illustrates the revised level of small refiner bias benefits:

Maximum Value of Small Refiner Bias Benefits Adopted at Representative Crude Run Levels

Crude runs (B/D)	*Maximum daily value of bias*	*Maximum per barrel value of bias*	*Maximum incremental per barrel value of bias**
10, 000	\$9, 600	\$0. 96	\$0. 315
30, 000	15, 000	. 53	—. 095
50, 000	14, 000	. 28	—. 10
100, 000	9, 000	. 09	—. 12

*The incremental per barrel value of the bias is the value or cost of the bias for each additional barrel that a small refiner increases its crude runs beyond the level shown in the first column.

Source: 44 Fed. Reg. 25621, 25624 (May 2, 1979).

f. Other administrative actions

Other announced administrative actions which have not yet been implemented include:

1. allowing producers, as of January 1, 1980, who invest in tertiary recovery processes to release a specified amount of lower tier oil to the upper tier price in order to provide "up front" money to finance the project.
2. allowing upper tier oil prices to increase, in equal monthly increments, to the world price between January 1, 1980 and October 1, 1981; and
3. elimination of price controls on natural gas liquids, such as propane.

B. Income Tax Provisions

1. Intangible drilling costs

Under present law, the operator of an oil, gas, or geothermal well has a one-time option to deduct intangible drilling and development costs (IDCs) currently as an expense rather than to capitalize the costs and recover them through depletion or depreciation deductions over the life of the well (sec. 263(c)). Generally, IDCs are those expenditures made by the owner of the operating interest for wages, fuel, repairs, hauling, supplies, etc., incurred in preparing a drill site, drilling and cleaning a well, and constructing assets which are necessary in drilling the well and preparing it for production (such as derricks, pipelines, and tanks). The IDC option applies both to domestic and foreign drilling. The cost of drilling a dry hole generally is deductible currently without regard to the election to expense IDCs.

In the case of noncorporate taxpayers, excess IDCs are an item of tax preference subject to the minimum tax (sec. 57(a)(11)). Excess IDCs are those costs which are incurred in a taxable year, in excess of the amount of those costs amortizable on the basis of a 10-year life or under cost depletion and in excess of the taxpayer's income from oil and gas properties.

Gain on the disposition of an oil property is subject to recapture, *i.e.*, treated as ordinary income rather than as capital gain, to the extent that the amount of the IDC deductions exceeds the amount which would have been allowable had the costs been capitalized and deducted through cost depletion (sec. 1254).

2. Depletion

Generally, percentage depletion is not available in the case of oil production (sec. 613A(a)). However, independent producers and royalty owners, those not involved in the "downstream" parts of the oil business, are entitled to percentage depletion to the extent that their average daily production does not exceed a specified exemption. For 1979, the exemption is 1,200 barrels per day (438,000 barrels per year). The exemption will be established permanently at 1,000 barrels per day in 1980 (365,000 barrels per year). Through 1980, the applicable depletion rate is 22 percent of gross income from the property. Thereafter, the rate is scheduled to be phased down to a permanent level of 15 percent of gross income in 1984. The depletion deduction resulting from this exemption may not exceed 65 percent of the taxpayer's overall net taxable income, computed without regard to the depletion deduction, net operating loss carrybacks, or capital loss carrybacks (sec. 613A(d)(1)). In addition, the depletion deduction from any single property may not exceed 50 percent of the taxpayer's taxable income from the property, computed without regard to the depletion deduction (sec. 613(a)). For all taxpayers, any excess of the allowable depletion deduction, with respect to each property, over the adjusted basis of that property at the end of the taxable year, is treated as an item of tax preference subject to the minimum tax. Oil production eligible for percentage depletion represents approximately 23 percent of domestic production.

3. At risk

The amount of any loss (otherwise allowable for the year) which may be deducted in connection with exploring for, or exploiting, oil resources, cannot exceed the aggregate amount with respect to which the taxpayer is at risk in connection with the property at the close of the taxable year, *i.e.*, generally the amount of an otherwise allowable loss for the year cannot exceed the taxpayer's basis in the property reduced by any nonrecourse borrowing to which the property is subject. This limitation applies to all taxpayers except corporations which are not subchapter S corporations or personal holding companies.

4. Investment credit

A 10-percent investment tax credit (ITC) generally is available for depreciable property that is (1) tangible personal property, or (2) other tangible property (not including a building or its structure components) if such property is used as an integral part of manufacturing production, extraction, or transportation, or is a research or bulk storage facility used in connection with such activities. The ITC extends to any tangible property (other than a building and its structural components) used as an integral part of the extracting, processing, or refining of minerals (including oil and gas); to oil and gas pipelines, derricks, and storage tanks; to any vessel documented under the laws of the United States that is operated in the domestic or foreign commerce of the United States; and to any property (other than a vessel or aircraft) of a United States person used for exploring for, developing, removing, or transporting resources from the Outer Continental Shelf or from international or territorial waters or deposits under such waters in the northern portion of the Western Hemisphere (sec. 48(a)(1); 48(a)(2)(B)(vi) and (x)).

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IV. PRIOR CONGRESSIONAL ACTION

Since 1974, both the House Ways and Means and Senate Finance Committees have agreed to tax bills including a windfall profits tax on crude oil, natural gas liquids, or both.

Essentially, a windfall profits tax on oil is an excise tax designed to tax away all or part of the difference between the controlled price of oil and the higher world price of oil. The cost of oil to the consumer would rise in response to a decontrol of oil prices, but the "windfall" to the producer because of this increase would be reduced or eliminated by the windfall tax.

1974 Proposals

In late 1973, President Nixon proposed a windfall profits tax. In 1974, the Ways and Means Committee reported two substantially similar bills, H.R. 14462 (H. Rept. No. 93–1028, 93d Cong., 2d Sess. (1974)) and H.R. 17488 (H. Rept. No. 93–1502, 93d Cong., 2d Sess. (1974)), which included a windfall profits tax on crude oil. (The bills also would have phased out percentage depletion on oil and gas.) Those bills, however, were not taken up on the House floor.

At the time of the Committee's action, about two-thirds of United States' oil production (old oil) was subject to price controls at prices averaging about $5.25 per barrel. The remaining production (new oil, released old oil and stripper oil) was uncontrolled and was selling at much higher prices. The windfall profit tax reported by the Committee was an excise tax in which the tax rate for a particular barrel of oil depended on the difference between a base price and the selling price of that barrel. The base price was the selling price of oil of similar grade, type and location determined as of December 1973, before the price of oil was affected significantly by the OPEC cartel, plus 50 cents. This base price averaged $4.75 per barrel. The tax rate ranged from 10 percent of the first 25 cents by which the selling price exceeded the base price to 85 percent of the excess over $2.00. Thus, there was a very modest tax on price controlled oil but a sizable tax on uncontrolled oil.

The tax phased out over a 5-year period. This phaseout was accomplished by raising the base price, and thereby reducing the tax rate. (Subsequently, most windfall profit tax proposals have used phaseouts based on decline curves because that method reduces any incentive to withhold production until completion of the phaseout.) Also, it contained a "plowback" provision under which producers could receive a credit against the windfall profit tax for 100 percent of qualifying investment above a threshold level. Except for the first year of the tax, the plowback credit could have completely offset all windfall profits tax liability.

1975 Proposal

In 1975, during the course of the markup on H.R. 6860, the Ways and Means Committee considered the possibility of including a windfall profit tax on oil and/or natural gas. This tax would have been contingent on price decontrol. However, the windfall profit tax was not included as part of the reported bill because the Committee decided that it could not write a windfall profit tax without knowing the exact nature of the phaseout of controls.

In August 1975, the Finance Committee agreed to a deregulation profit tax on oil and natural gas liquids which was to have been offered as a Finance Committee floor amendment to a tariff bill. This deregulation tax was conditioned on price decontrol, and the measure died when proposals then pending for rapid or immediate decontrol of energy prices failed to win approval.

The Finance Committee's windfall profit tax would have imposed a 90-percent windwall profit tax on old oil to the extent that the price of that oil exceeded the controlled price ($5.25 per barrel on the average), and on new oil to the extent that the sales price exceeded $11.50 per barrel. A tax would have been imposed on natural gas liquids to the extent that the price exceeded the regulated price in effect on June 30, 1975. The tax was phased out over a 5½-year period using a 1.5 percent per month decline curve. There was a plowback credit, but it was limited to 25-percent of the tax otherwise due. The net proceeds from the tax were to be rebated on a per capita basis to all individuals who were 18 years of age or older.

1977 Proposal

In conjunction with its 1977 legislative program, the Administration proposed a number of oil and gas related taxes, including a tax on the industrial use of oil and natural gas, and a three stage "crude oil equalization tax" (COET). The effect of the COET would have been essentially similar to a combination of a phased decontrol of crude oil prices and a 100-percent windfall profit tax.

The House passed a modified form of the COET, in conjunction with a natural gas liquids equalization tax.[1] These taxes would have been phased in between 1978 and 1980 and would have terminated on September 30, 1981. For 1978 and 1979, only lower tier oil would have been subject to the COET. For 1978, the tax would have been one-half of the difference between the controlled prices of similarly classified new and old oil, and from 1979 the tax would be the full difference between these prices. From 1980 until the termination date, all controlled oil would have been taxed in an amount equal to the difference between each classification's controlled and uncontrolled prices. The tax would have terminated on September 30, 1981. The cost would have permitted elimination of price regulations on oil refiners and marketers after 1979.

Under the House-passed bill, the President would have been granted standby authority, subject to congressional veto, to suspend increases in the equalization taxes pursuant to a finding that the increase would

[1] H.R. 8444, H. Rept. No. 95–496, 95th Cong., 1st Sess., Pt. III (1977).

cause a substantial adverse economic effect. The bill also provided an exemption from the tax for home heating oil through payments to retailers of heating oil, and specified rebates of those taxes to the general public.

The Senate did not pass either of these taxes, and the conference committee did not agree to their adoption.

V. DESCRIPTION OF BILLS

A. H.R. 3919 (Mr. Ullman)

1. Overview

This bill represents the Administration's proposed windfall profit tax with some technical amendments.

Under the bill, a 50-percent windfall profit tax would be imposed on crude oil price increases resulting from either price control deregulation or from future OPEC prices increases. The tax generally would apply to price increases in excess of the amount to which producers would have been entitled if the price control regulations which were effective prior to President Carter's phased decontrol program had been retained with adjustments for inflation. However, there are certain exceptions which exempt some of these price increases from the tax.

The tax would apply to the first sale of domestically produced crude oil. The tax would apply to the difference between the actual selling price of the oil and the adjusted ceiling price (as of May 1979) for such oil, adjusted for inflation. Certain limited exceptions to the tax are provided, however, for oil produced north of the Arctic Circle, stripper oil, oil from marginal properties, "newly discovered oil," for any incremental production resulting from tertiary recovery processes, and for oil production in excess of a 2-percent monthly decline curve.

The tax would be effective on January 1, 1980.

2. Taxable oil

The tax generally would apply to the sale of all domestically produced crude oil. However, oil produced north of the Arctic Circle would be exempt.

Taxable crude oil would be classified in one of three tiers. The first tier, which would have the highest tax, would essentially be oil that is now priced as lower tier oil but which will be released to the upper tier and eventually deregulated under the Administration's pricing policy. However, the first tier will phase out by June 1983. The second tier would consist of oil that is now upper tier oil, oil exempted from the first tier by reason of the phaseout of that tier through a decline curve, and oil produced on "marginal properties." The third tier, which would have the lowest tax rate, would include stripper oil, newly discovered oil, and oil produced from tertiary recovery. Between 1986 and 1990, the second tier would phase into the third tier.

3. Structure of tax

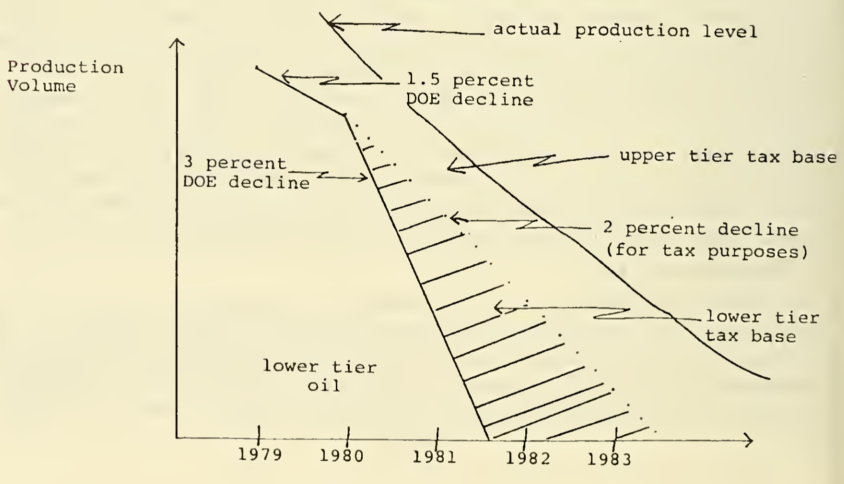
The tax contained in the bill would have a separate rate for three tiers of oil: (1) oil below a 2-percent monthly decline curve, (2) oil in excess of the decline curve and (3) special categories of oil exempt from tiers 1 and 2. The tax rate would be 50 percent of the difference between the actual selling price of the oil and the base price appropriate to that tier. For tier 1, the initial base price would be the May 1979 ceiling price of lower tier oil, which averages about $6 per barrel. For tier 2, it would be the May 1979 ceiling price of upper tier oil, which averages about $13 per barrel. For tier 3, it would be $16 adjusted for quality and location differentials. In each instance the base price, with respect to which any windfall profit is measured, would be adjusted quarterly for net increases in the GNP deflator which occur for the calendar quarter ending December 31, 1979 (June 30, 1979 in the case of tier three oil). This adjustment standard basically is the same as that currently used under DOE regulations pursuant to EPCA. The windfall profit subject to tax under the bill is any amount by which the price of a barrel of oil exceeds its adjusted 1979 base price.

a. Tier 1 tax rate

The amount of oil subject to the tier 1 tax rate would be oil produced on a property below the amount represented by a decline curve. Through 1979, the decline curve would be exactly the same as under price controls—1.5 percent per month; however, starting in January 1980 the rate would be 2 percent per month (as opposed to the 3 percent per month under price controls). Thus, the oil taxed under the tier 1 tax rate would be oil released to the upper tier by virtue of the 3-percent decline curve under price controls but below the 2-percent monthly decline curve used under the tax. The tier 1 tax base does not include oil produced from marginal properties, stripper wells, or incremental tertiary production.

Figure 2 indicates the operation of the tier 1 tax under the announced decontrol schedule. The solid line in the lower left of the figure represents adjustments to the BPCL under the DOE regulations published on April 12, 1979 (44 Fed. Reg. 22010), that is, a 1.5-percent reduction in the BPCL for each month in 1979, and a 3-percent reduction for each month after 1979 (until control authority ends on September 30, 1981). The dotted line represents the 2-percent monthly reduction in the BPCL allowed for purposes of the proposed lower tier tax.

FIGURE 2



The shaded area between these two lines is the tier 1 tax base, i.e., the amount by which the DOE allowable decline exceeds that permissible under the tax. Since production at or below the DOE level can be sold only at lower tier controlled prices, it is not subject to the windfall profit tax; production in excess of the 2-percent line is subject to the windfall tax at the tier 2 rate. After control authority ends, and the 3-percent decline has phased out lower tier oil for DOE purposes, in September, 1981, all oil below the 2-percent monthly decline curve would be subject to the tier 1 tax rate until May 1983 when the 2-percent decline rate phases out as well.

Example.—The operation of the lower tier tax can be illustrated by the following example:

> Producer A's BPCL for lower tier oil as of January 1, 1979, is $100X$ barrels per day. Under the Department of Energy decontrol schedule the volume of oil produced on the property subject to lower tier prices on December 31, 1979, will be $82X$ barrels per day ($100X$ barrels per day less $18X$ barrels per day representing a 1½ percent decline for the 12 months of 1979). During January, 1980, A produces $83X$ barrels per day ($82X$ barrels minus $3X$ barrels for the January 1980 decline). Of that production, $4X$ barrels can be sold as upper tier oil, because the lower tier volume for January 1980 is $79X$ barrels per day. One X barrel per day, the difference between the DOE 3-percent rate and the 2-percent tax decline rate, is the volume of oil taxed at the tier 1 rate. Thus, if the inflation-adjusted controlled price of lower tier oil in January 1980 is \$6 per barrel and the $1X$ taxable barrel per day is sold at the wellhead at an upper tier ceiling price of \$13 per barrel, the amount of tax would be equal to: 50 percent × ($1X$ barrel per day × 31 days) × (\$13 per barrel − \$6 per barrel) = \$108.50X. The other decontrolled oil produced in January 1980 (31 days × $3X$ barrels per day) would be included in the upper tier taxable volume of oil subject to the tier 2 tax rate.

b. Tier 2 tax rate

The tier 2 tax rate would equal 50 percent of the difference between the actual selling price of oil in that tier and the May 1979 upper tier ceiling price, adjusted for inflation. As the upper tier ceiling price is increased to the world price during the phased deregulation, this tax rate will increase to one-half the difference between the world price and the inflation adjusted upper tier ceiling price.

The upper tier tax base includes oil produced from marginal properties and oil produced on a property in excess of the 2-percent monthly decline rate. However, it does not include oil produced north of the Arctic Circle, stripper oil, "newly discovered oil," or any incremental production resulting from approved tertiary recovery projects.

The constructive upper tier base price would increase in monthly increments beginning in November 1986 so that this phase of the tax will disappear by the end of 1990. The Secretary of the Treasury would prescribe by regulations the applicable monthly increments.

The upper tier tax base is shown in Figure 2 by the unshaded area between the dotted 2-percent tax decline curve and the solid line on the right of the Figure.

c. *Tier 3 tax rate*

The tier 3 tax would apply to oil not covered by either of the first two tax bases, except for oil produced north of the Arctic Circle including North Slope oil, which is exempt from the entire tax. In such an instance, the windfall profit is the difference between the adjusted price, prescribed by Treasury regulations, at which uncontrolled crude oil of the same grade, quality, and location would have sold in December 1979 if the average landed price for imported crude oil were $16 a barrel, and the wellhead sale price. Using this formula should prevent the tax from being imposed solely on price differentials attributable to the quality of the oil.

4. Tax calculation

In computing the tax, taxpayers could not deduct State severance taxes.

The windfall profit on a barrel of crude oil may not exceed 100 percent of the net income attributable to the barrel. Net income for a taxable period would be determined by dividing taxable income from a property by the number of barrels of taxable crude oil produced from the property. Taxable income would be computed without any deductions for depletion, for the windfall profit tax, or for intangible drilling and development costs. (However, the costs of drilling a dry hole would be allowed.)

Generally, the purchaser of crude oil would collect and pay over, on a semi-monthly basis, the windfall profits tax imposed with respect to such oil by deducting the amount of such tax from the amounts payable to the producer. If the tax paid exceeds the net income limitation, producers could obtain refunds of overpayments made by the purchaser. The producer, that is the holder of the economic interest with respect to the crude oil, would be treated as having paid the tax. However, in the case of certain production payments, in which the windfall profit is not really received by the person with the economic interest, the holder of the economic interest in the property from which the production payment was created, and not the holder of the production payment, would be required to pay the windfall profit tax. Purchasers would be required to provide producers with monthly information statements on such tax payments. Willful failure to furnish such information would be subject to criminal penalties.

Although the windfall profit tax would be imposed on holders of an economic interest, in the case of actual sales before the oil is removed from the premises, the bill provides for the purchaser's collection of the tax by deducting it from the purchase price. Generally, under existing business practices, records, called run statements, are maintained of the price and the actual per barrel quantity sold or removed from the premises at a given time. Prior to the purchaser's payment for the oil, "division orders" generally are circulated by the purchasesr among the various owners of interest in the property for their signatures. These records show the fractional interest in the oil sold or removed. They also are used for determining the amount of sales proceeds due to each party, and for purposes of determining each party's respective depletion deduction. However, it is on the basis of the division orders that the purchaser generally makes the payment directly to the owner of each interest for the applicable share of the proceeds, after reduction for severance or production taxes. In addition, since each computation relative to the determination of the net proceeds payable to each interest owner have to be shown on these commonly used records, each party will have sufficient information to calculate the appropriate depletion deduction.

In determining percentage depletion under the income tax, gross income from the property would be reduced by the full amount of the windfall profit, not only the amount of the windfall profit tax, and taxable income would be determined without regard to the tax.

5. Effective date

The tax would be effective on January 1, 1980.

6. Windfall profit tax revenues and Energy Trust Fund

The bill also would create a special trust fund for the receipts of the windfall profit tax.

The Energy Trust Fund under the bill generally would be similar to existing trust funds administered by the Secretary of the Treasury. The Secretary would determine the amounts to be transferred to the fund on a monthly basis. Such amounts generally would be equivalent to the revenue produced from the windwall profit tax. The Secretary would manage the trust fund as the trustee, and would be required to report on its financial condition each year after September 30, 1980. This report would include the results of operating the fund for the fiscal year, and a projection of its condition for the following 5 fiscal years. Any amounts not in use currently would be required to be invested in interest-bearing obligations of the United States. Any interest earned on the fund's investments would be credited to it.

Amounts in the trust fund would be available, as provided by appropriations Acts, for expenditures for purposes to be specified by law.

The Administration estimates that the net revenue from its proposed windfall profit tax, allowing for its being deductible under the income tax, would be $0.5 billion in calendar year 1980, $1.5 billion in 1981, and $1.7 billion in 1982. The revenue placed in the trust fund, the gross windfall profit tax, would be $0.8 billion in 1980, $2.5 billion in 1981, and $2.8 billion in 1982. (Prior to mark up, the staff will present its own estimates of the revenue effect of the tax.)

B. H.R. 3421
(Messrs. Cotter, Lederer, and Shannon)

1. Overview

The bill would impose a windfall profit tax on crude oil produced from domestic oil wells. The tax would be an excise tax set at 85 percent of the windfall profit on each barrel of taxable crude oil.

2. Taxable oil

Crude oil subject to the tax would include oil produced from a well located in the United States or in a U.S. possession which would have been subject to price controls if the oil price control regulations in effect in March 1979 were continued. Oil designated as "newly discovered oil" according to rules similar to the rules for determining new natural gas under section 102 of the Natural Gas Policy Act of 1978 would be exempt from the tax imposed by this bill. This exemption would cover oil produced from new Outer Continental Shelf leases; from new onshore wells which are at least 2.5 miles from the nearest existing well or at least 1,000 feet deeper than any existing well within 2.5 miles; and oil from a reservoir which did not produce commercial quantities before April 20, 1977. In addition, crude oil produced from a well north of the Arctic Circle would be exempt from the tax.

3. Tax base

The windfall profit subject to tax under this bill would be the amount by which the price of a barrel of crude oil exceeds its adjusted base price. The adjusted base price for a barrel of oil would be the price in March 1979 under the price controls for oil from the same property (or oil of the same grade and location if no oil was produced from the property in March 1979), adjusted monthly for inflation occurring after March 1979.

4. Tax calculation

Taxpayers could deduct the increase in State severance taxes in excess of what would have been imposed if the barrel had been extracted and sold on March 31, 1979, at its base price. (For this purpose, increases in the rate of severance taxes after March 31, 1979, would not be taken into account.)

The windfall profit on a barrel of crude oil could not exceed the net income attributable to the barrel. Net income for a taxable period would be determined by dividing taxable income from a property by the number of barrels of taxable crude oil produced from the property. Taxable income would be computed without any deductions for depletion, for the windfall profit tax, and for intangible drilling and development costs. (However, the costs of drilling a dry hole on the property would be allowed.)

Generally, the purchaser of crude oil would collect and pay over the windfall profit tax imposed with respect to such oil by deducting the amount of such tax from the amount payable to the producer. The producer, that is the person entitled to the depletion deduction with respect to the crude oil, would be treated as having paid the tax.

For purposes of determining percentage depletion under the income tax, gross income would be reduced by the amount of the windfall profit tax.

5. Effective date

The provisions of the bill would become effective on the first day of the first month beginning after the date of enactment.

C. H.R. 3474

(Messrs. Conable, Vander Jagt, Frenzel, Martin, Bafalis, and Gradison)

1. Overview

Under the bill, a 25 percent oil deregulation tax would be imposed on all crude oil price increases resulting from price control deregulation.

The tax generally would apply to the first sale of all domestically produced crude oil that would have been subject to price controls under current DOE regulations. The tax would apply to the difference between the actual or constructive selling price of the oil, and the adjusted May 31, 1979 controlled price for that oil. Exceptions to the tax would be provided, however, for Alaskan North Slope oil, stripper oil, "newly discovered oil," for production resulting from tertiary recovery processes, and for small producers.

A credit against the tax would be provided for qualifying energy investments in excess of a credit threshold.

The tax would apply to taxable crude oil removed from the premises between June 1, 1979 and September 30, 1981.

2. Taxable oil

The tax generally would apply to the first sale of domestically produced crude oil that would have been subject to price controls under the DOE regulations in effect on May 31, 1979. Thus, the bill would not apply to stripper oil and Alaskan North Slope oil. In addition, newly discovered crude oil and crude oil produced from tertiary recovery processes are specifically exempted from the tax. "Newly discovered crude oil" would be defined as any crude oil produced from a well the surface drilling of which began after April 5, 1979, on a property (as defined pursuant to DOE regulations in effect on April 4, 1979) from which there had been no commercial oil before April 5, 1979. An exemption from the tax is also provided for the production of small producers that does not exceed a daily average of 1,200 barrels.

3. Tax base

The tax contained in the bill would be imposed on crude oil that would have been subject to a first sale ceiling price under DOE regulations in effect on March 31, 1979. The base price with respect to which any windfall profit would be measured by the May 31, 1979, first sale ceiling price adjusted for inflation and any increase in severance taxes. The deregulation price increase subject to tax is any amount by which the actual or constructive selling price of a barrel of oil exceeds the base price.

4. Tax calculation

The deregulation price increase of a barrel of crude oil could not exceed 75 percent of the net income attributable to the barrel. Net income for a taxable period would be determined by dividing taxable income from a property by the number of barrels of taxable crude oil produced from the property. Taxable income would be computed without any deductions for depletion, for the oil deregulation tax, or for intangible drilling and development costs. (However, the costs of drilling a dry hole would be allowed.)

5. Tax credit

A credit against the tax would be permitted for qualified energy investments in excesst of base period amount, adjusted for inflation. Qualifying energy investments include intangible drilling and developments costs geological and geophysical costs, costs of depreciable assets used in oil and gas extraction activities, or oil shale, coal, or liquid hydrocarbon conversion, and secondary and tertiary recovery costs.

Generally, the tax would be imposed on the person entitled to the deduction for depletion with respect to the taxable crude oil.

For purposes of determining percentage of depletion under the income tax, gross income would be reduced by the full amount of the oil deregulation tax.

6. Effective date

The tax generally would be effective as of June 1, 1979.

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