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ANALYSIS OF TAX DATA OF SEVEN MAJOR OIL COMPANIES

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OF THE

COMMITTEE ON GOVERNMENT OPERATIONS

UNITED STATES SENATE

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Memorandum

To: Members of the Permanent Subcommittee on Investigations.
From: Henry M. Jackson, Chairman.
Subject: Study of Taxation of Oil Companies.

Last January representatives of the seven largest U.S. oil companies—Exxon, Texaco, Mobil, Standard Oil of California, Gulf, Standard Oil of Indiana and Shell—appeared before the subcommittee to testify on petroleum shortages and other related matters.

In conjunction with those hearings, I requested the oil companies to supply their tax returns for the latest 5 years available. The returns, covering the years 1968 through 1972, were obtained pursuant to Executive Order 11711, dated April 13, 1973.

This committee print analyzes and distills information received from the tax returns of the major oil companies. The objective of the print is to (1) establish the effective tax rates paid by those major oil corporations, and (2) determine the use and interrelationship of special deductions available to all corporations and those peculiar to the extractive industries.

Although each member will undoubtedly draw his own conclusions from the data presented, I found most significant the extremely low effective tax rates of the major oil companies as well as the large reduction in tax liabilities stemming from percentage depletion allowances.

To preserve the confidentiality of the data, the companies are referred to by letter, randomly designated, rather than by name. In addition, aggregate figures for the seven companies are used along with five year averages for individual companies.

In compiling the data for this Committee print we were fortunate to have had the able assistance of the Statistics Division of the Internal Revenue Service. The print itself was written by Jane Gravelle of the Congressional Research Service, Economics Division, to whom we are highly indebted. I would also like to thank the ranking minority member, Senator Charles H. Percy, for his assistance and cooperation in preparing this study.

ANALYSIS OF TAX DATA OF SEVEN MAJOR OIL COMPANIES

Summary

The following tables and explanatory material are an analysis of tax data for seven major oil companies over a 5-year period, 1968–1972. These companies are Exxon, Texaco, Mobil, Standard Oil of California, Gulf, Standard Oil of Indiana, and Shell. The tax data were tabulated from tax returns obtained by the Senate Permanent Subcommittee on Investigations under Executive Order 11711, dated April 13, 1973. In order to preserve the confidentiality of the data, the companies have been randomly designated by the letters A through G and the tables reflect 5-year averages or aggregated amounts.

One objective of the analysis was to establish the effective tax rate paid by the major oil companies. Effective tax rate is defined as the Federal income tax actually paid as a percentage of net income. Except for the first $25,000 of each corporation's taxable income, the corporate tax rate is 48%. We also sought to determine how the effective tax rate was reduced both by extraordinary deductions permitted all taxpayers (such as accelerated depreciation) and those peculiar to the extractive industries (such as percentage depletion allowances).

In the 5 years from 1968–1972, five of the seven companies paid between 1.32% and 5.56% of their net income in United States income taxes while paying between 24.87% and 31.44% to foreign governments in payments designated as income taxes (Table 1A).

In 1972, the pre-tax net income of the seven companies combined totalled approximately $10.2 billion; they paid approximately $2.9 billion in foreign "income taxes" and only approximately $450 million in United States income taxes. The effective United States tax rate for the group was 4.41% and the effective foreign "income tax" rate was 28.70%. Effective United States income tax rates from 1968 through 1971 for the group ranged from 2.55% to 5.36% while effective foreign "income tax" rates ranged from 19.49% to 26.67% (Table 1B).

Both Tables 1A and 1B compute the effective income tax rates on net income not reduced by provisions for United States income taxes or deductions for foreign taxes paid which have been deemed income taxes. This is in accordance with rulings issued by the Internal Revenue Service that such payments to foreign governments are not royalties, severance taxes, or excise taxes but income taxes, qualifiying for the tax credit provisions of the Internal Revenue Code.

Effective U.S. tax rates were recomputed in Tables 2A and 2B with net income reflecting a deduction for all foreign income taxes paid—thus viewing them as royalties or similar type payments; i.e., a cost of doing business. The lower net income produced slightly

higher effective U.S. income tax rates. Table 2A shows effective U.S. tax rates for five of the seven companies of between 1.82% and 7.39% (compared with 1.32% and 5.56% in Table 1A).

The effective tax rate is less than the 48% nominal corporate income tax rate because of extraordinary deductions available to all taxpayers and because of special deductions available to companies in the extractive industries. Table 2A shows five-year averages (1968–1972) for each of the seven companies. For example, Company E's U.S. tax rate of 48% immediately falls by about one-half, to 24.17%, as it takes deductions available to other taxpayers but deemed special or extraordinary in nature—accelerated depreciation, the investment tax credit, capital gains and others.* Percentage depletion, as adjusted by the minimum tax, reduced Company E's U.S. effective tax rate to 8.50%. Deductions for intangible drilling costs further reduced Company E's U.S. effective tax rate to 6.06%. Finally, the foreign tax credit reduced Company E's U.S. effective tax rate to 1.82% over the years 1968–1972.

In 1972, the composite United States corporate tax rate of the seven companies was reduced from 48% to 23.39% through the "special" non-oil tax preferences cited above; from 23.39% to 9.84% through percentage depletion (adjusted by the minimum tax); from 9.84% to 8.88% by expensing of intangible drilling costs and from 8.88% to 6.18% by means of the foreign tax credit. These results follow the pattern exhibited in prior years (Table 2B).

Depletion deductions for the seven companies were aggregated for each year and compared to total industry deductions. In 1971, the latest year available for comparative purposes, the seven companies took approximately $2.3 billion in depletion deductions or approximately 57% of the industry total (Table 3).

Foreign tax credits of the seven companies were also aggregated for each year. In 1971, the latest year available for comparative purposes, the companies took approximately 40% of the foreign tax credits taken by the oil industry and approximately 15% of those taken by all United States corporations (Table 4).

The creation of a Western Hemisphere Trade Corporation permits a reduction in tax rate. With regard to the extractive industry, an important feature of this type of corporation is that it permits the use of percentage depletion, not otherwise available in the case of a foreign subsidiary. In 1970, the last year available for comparative purposes, the group of seven companies accounted for approximately 90% of the Western Hemisphere Trade Corporation deductions taken in the oil industry and 38% of the deductions taken by all corporations (Table 5).

The minimum tax was instituted to subject certain previously tax free items to at least some tax. Figures available for 1971 show that the minimum tax had a significant impact on the seven companies (increased tax liability by 26.94%) and on the oil industry (increased tax liability by 28.24%) while having little effect overall on all United States Corporations (increased tax liability by 1%) (Table 6).

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*A list of most of these tax provisions may be found in "Estimates of Federal Tax Expenditures," Committee on Ways and Means, prepared by the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation, June 1, 1973.

Effective Tax Rates

Tables 1 and 2 provide data on the effective tax rate, or the actual percentage of net income paid in taxes, of seven major oil companies: Exxon, Texaco, Mobil, Standard Oil of California, Gulf, Standard Oil of Indiana and Shell. A 5-year effective tax rate average is given for each company which, to maintain confidentiality, is designated by letter. The aggregate results for all seven companies, including both dollar amounts and percentage results, are provided for each of the five years. The discussion of the results and implications of the analysis are directed towards the aggregate results.

Table 2 focuses on a number of provisions of the Internal Revenue Code which are charged to be of special benefit to oil companies and result in reducing their effective tax rates below those in other industries. These provisions include:

(1) *Percentage depletion* (Sections 613–614 of the Internal Revenue Code of 1954). Cost depletion allows a write-off based on original cost and is similar to depreciation. Percentage depletion allows a deduction equal to 22% of gross income after royalties. Percentage depletion is therefore unrelated to actual cost and results in deductions exceeding cost.

(2) *Expensing of intangible drilling costs.* (Section 263(c) of the Internal Revenue Code of 1954). Under present code provisions, intangible drilling costs may be expensed—deducted in the year incurred—rather than being prorated over the life of the well, as would normally be the tax treatment of such capital expenditures. This allows a deferral of taxes. The advantage in deferring taxes is the interest which may be earned on deferred taxes. In addition, if continual investment is made the deferral may become a permanent tax savings.

(3) *Treatment of foreign production taxes for purposes of the foreign tax credits* (Sections 901–906 of the Internal Revenue Code of 1954). Under present code provisions, foreign income taxes paid are deducted from the United States tax liability to determine the ultimate tax due. Under Internal Revenue Service rulings, foreign production taxes are treated as income taxes and hence qualify for the foreign tax credit. The alternative approach would be to treat such foreign production taxes as royalties or severance or excise taxes, i.e., as costs of doing business. Two advantages arise from treating them as income taxes rather than royalties or production taxes. First, these production taxes are included in the gross income base for computing percentage depletion. Second, they reduce United States tax liability dollar for dollar (because they are creditable) rather than 48 cents on the dollar (if they were deductible costs).

Tables 1 and 2 show alternative measures of the effective income tax rate of the oil companies, based on different approaches to measuring the tax burden. Table 1 shows the income tax burden both in the United States and abroad, using the premise that foreign production

taxes paid by the oil companies are income taxes. Table 2 shows the United States income tax burden, assuming that foreign production taxes paid by oil companies are royalties or costs of production and not a tax on profits.

Accordingly, in Table 1, the base net income figure used to compute effective tax rates is income before foreign and United States income taxes (book net income plus foreign creditable taxes plus provision for United States income taxes). Table 1A presents three effective rates—foreign creditable taxes (deemed to be income taxes under IRS rulings), United States income taxes actually paid (regular income taxes plus the minimum tax on preference income [1]) and total income taxes.

The aggregate table (Table 1B) illustrates several aspects of the taxes paid by the oil companies. First, foreign taxes and the effective rates of foreign income taxes were fairly stable from 1968–1970 and then rose sharply in 1971. Second, United States income taxes and the effective tax rate were higher in 1968, dropped in 1969 and then climbed again in 1970, dropping slightly in the following two years. The table also illustrates that foreign income taxes claim a much larger and increasing share of total taxes paid than United States income taxes.

TABLE 1

A. EFFECTIVE TAX RATE: UNITED STATES AND FOREIGN INCOME TAX—5-YEAR AVERAGE, 1963–72

	Foreign income taxes	U.S. income taxes	Total income taxes
Company—			
A	3.56	7.20	10.76
B	25.27	3.08	28.34
C	31.44	2.32	33.77
D	25.59	2.30	27.90
E	27.37	1.32	28.70
F	.34	13.05	13.39
G	24.87	5.56	30.43

B. AGGREGATE—7 COMPANIES

[Money amounts in thousands of dollars]

Year	Pretax net income [1]	Foreign income taxes [2]	U.S. income taxes [3]	Total U.S. and foreign income taxes	Effective rate		
					Foreign income taxes	U.S. income taxes	Total income taxes
1968	$7,576,607	$1,477,056	$294,018	$1,771,074	19.49	3.88	23.88
1969	8,161,889	1,623,103	208,500	1,831,603	19.89	2.55	22.44
1970	8,848,243	1,735,324	474,570	2,209,894	19.61	5.36	24.98
1971	9,460,257	2,522,981	467,467	2,990,488	26.67	4.94	31.61
1972	10,236,458	2,938,012	450,985	3,388,997	28.70	4.41	33.11

[1] Net income per book plus provision for Federal income taxes plus foreign creditable income taxes paid and deemed paid.
[2] Taxes paid and deemed paid.
[3] Regular plus minimum income tax.

As noted earlier, Tables 2A and 2B assume that foreign production taxes are royalties, or a cost of doing business rather than a tax on profits.[2] Accordingly, in Tables 2A and 2B the base net income figure

[1] The minimum tax is an additional tax imposed on certain items of preference income including the excess of percentage depletion over the adjusted basis of the property. In computing the minimum tax, the taxpayer deducts from preference income $30,000 plus regular income taxes and then applies a 10% rate.
[2] In preparing these tables certain foreign taxes paid in non-producing countries are treated as costs, although clearly in the nature of income taxes. However, there was no way to separate these taxes and hence, for the purposes of this table, the entire tax is treated as a deduction. The result is a slightly lower effective tax rate than might be the case if such taxes which are more clearly income taxes are treated as income taxes.

used to compute effective tax rates is net income before Federal income taxes but reflecting a deduction for all foreign taxes paid. These tables show how much of the departure from the corporate tax rate of 48% is accounted for by various tax provisions, including percentage depletion, expensing of intangible drilling expenses and the foreign tax credit. The value of percentage depletion is entered as the difference between tax and book depletion multiplied by the tax rate (48%) and reduced by the minimum tax.[3] The value of expensing intangibles was entered as the difference between tax and book cost multiplied by the 48% tax rate. The value of the foreign tax credit was entered as the difference between foreign tax credit taken and 48% of foreign taxes paid.

[3] The minimum tax was presumed to reduce the value of percentage depletion since without percentage depletion it is relatively unlikely that any minimum tax would have been due.

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TABLE 2-A.—FIVE-YEAR AVERAGE, 1968-72

	Company A	Company B	Company C	Company D	Company E	Company F	Company G
Statutory rate	48.00	48.00	48.00	48.00	48.00	48.00	48.00
Effective rate after reduction in tax liability due to:							
Provisions other than percentage depletion, intangible drilling costs and foreign tax credit	19.70	31.30	29.73	26.42	24.17	34.26	21.10
Percentage depletion (initial)	8.94	9.83	9.27	13.56	7.63	10.63	9.57
Percentage depletion (adjusted for effect of minimum tax)	9.89	11.59	10.70	14.28	8.50	13.34	9.82
Expensing of intangible drilling costs	8.14	9.98	8.28	13.83	6.06	13.20	9.82
Foreign tax credit (actual effective tax rates)	7.47	4.12	3.39	3.10	1.82	13.09	7.39

TABLE 2-B.—AGGREGATE

[Money amounts in thousands of dollars]

	1968		1969		1970		1971		1972	
	Amount	Resulting effective tax rate	Amount	Resulting effective tax rate	Amount	Resulting effective tax rate	Amount	Resulting effective tax rate	Amount	Resulting effective tax rate
Item—										
1. Pretax net income	$6,099,551		$6,538,786		$7,112,919		$6,937,866		$7,298,446	
2. Expected tax liability at 48 percent rate	2,927,783	48.00	3,138,614	48.00	3,414,191	48.00	3,330,172	48.00	3,503,250	48.00
3. Reduction in tax liability due to provisions other than percentage depletion, intangible drilling costs and foreign tax credit	1,327,078	26.24	1,531,720	24.57	1,811,086	22.54	1,537,474	25.84	1,795,808	23.39
4. Reduction in tax liability due to percentage depletion:										
Initial	1,006,593	9.74	984,569	9.52	893,025	9.98	1,050,180	10.70	1,092,868	8.42
Reduced by minimum tax					89,326		99,217		103,483	
Adjusted					803,699	11.24	950,963	12.13	989,385	9.84
5. Reduction in tax liability due to expensing intangible drilling costs	70,533	8.58	106,089	7.89	60,138	10.39	42,109	11.53	70,247	8.88
6. Reduction in tax liability due to foreign tax credit	229,561	4.82	307,736	3.19	264,705	6.67	332,217	6.74	196,825	6.18
7. Actual taxes paid	294,018	4.82	208,500	3.19	474,570	6.67	467,467	6.74	450,985	6.18

Referring to the aggregate of the seven companies found in Table 2B, after establishing the base for net income in item 1, an indication of the amount of taxes due, if a 48% rate were applicable, is shown in item 2. For 1972, on net income of approximately $7.3 billion, taxes in the amount of $3.5 billion would have been due. The impact on the effective tax rate of "special" or "extraordinary" provisions of the tax law, other than percentage depletion, expensing of intangibles and the foreign tax credit is shown in item 3. These include such generally available provisions such as accelerated depreciation, the investment tax credit, and capital gains.[4] Thus, item 3 shows what the effective tax rate would have been after deductions for special tax preferences to all taxpayers but before deductions peculiar to the extractive industries—percentage depletion and expensing intangible drilling expenses—and before the foreign tax credit. Thus, for example, in 1972, treating the seven oil companies as other corporations, the nominal corporate tax rate of 48% would have been reduced to an effective tax rate of 23.39%. Treated as other corporations their total aggregated tax bill would have been approximately $1.7 billion ($3.5 billion computed under nominal corporate tax rate minus approximately $1.8 billion in special preference deductions indicated in item 3).

Item 4 illustrates the impact of percentage depletion on the effective tax rate. The percentage depletion deduction was clearly the most important of the provisions peculiar to the extractive industries in reducing the effective tax rate, accounting in the aggregate for about thirteen percentage points in 1972, reducing the aggregate effective tax rate to 9.84%, and reducing the seven companies tax bills by approximately $990 million.

Item 4 indicates that the relative importance of percentage depletion declined after 1969, which would be expected since the Tax Reform Act of 1969 reduced the percentage depletion rate from 27½% to 22% and imposed the minimum tax. However, it also suggests that for the years 1971 and 1972 the decline in relative importance is primarily attributable to the minimum tax rather than the reduction in percentage depletion rates.

Item 5 shows the impact of expensing, or deducting currently, intangible drilling costs on the effective tax rate. There are a number of difficulties in computing this item. Since it is a timing deduction whose value lies at least partially in deferring rather than reducing taxes, it is difficult to determine the actual value. An additional problem is that the items found in the tax return did not always indicate that the same definition of intangible drilling and development costs were used for both tax and book purposes. In any event, the computations show that the expensing of intangibles has a relatively small impact on effective tax rates, generally accounting for a one percentage point reduction. For 1972 these deductions further reduced the effective tax rate to 8.88%, saving the seven companies approximately $70 million.

Item 6 of the table measures the impact of the foreign tax credit on the effective tax rate. The value of the foreign tax credit is the difference between taking foreign taxes paid and deemed paid as a deduction and the actual foreign tax credit allowed. The impact of the foreign tax

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[4] Most of these items are found on a list prepared by the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation, "Estimates of Federal Tax Expenditures," Committee on Ways and Means, June 1, 1973.

credit has ranged from around three percentage points to around five percentage points, with the lowest impact in 1972. This lessened impact in the face of rising foreign taxes may reflect the inability of many companies to utilize the additional taxes paid because of the limitation on the foreign tax credit. (The foreign tax credit is limited to the United States taxes which would have been paid on foreign taxable income under either a per country limitation or an overall limitation). For 1972, the foreign tax credit further reduced the aggregate effective tax rate to its final figure—6.18%. It saved the seven companies approximately $197 million in that year.

The results of Table 2 indicate a relatively significant tax saving role for percentage depletion and a lesser one for the foreign tax credit. These results are misleading because they attribute the reduction of foreign taxes first to percentage depletion on foreign production and then to the foreign tax credit because of the way taxes are computed. In fact, these two items are closely tied to each other in their impact on United States taxation of foreign oil income, and the removal of either provision without removing the other as well will have only a limited impact on the taxation of foreign income.

This interrelationship can be illustrated on a simple per barrel example. Assume that a barrel of foreign oil is sold for $10. Assume that the foreign production taxes are $7, the actual cost of production 50¢ and the profit $2.50. Using the approach taken in Table 2, the $2.50 profit would be the base for computing the effective tax rate and the proper tax at the statutory rate would be $1.20 (48% of $2.50). If it is assumed that depletable costs have been recovered and the intangible drilling cost deduction is ignored, the tax would actually be figured this way:

Selling price	$10.00
Minus cost	.50
Minus percentage depletion (22 percent of $10)	2.20
Equals foreign taxable income	7.30
U.S. tax due at 48 percent	3.50

Since the $7 actually paid in taxes exceeds the $3.50, no tax will be paid to the United States. A table showing how the special tax provisions reduced the effective tax rate (from 48% to zero) would first show that percentage depletion was worth $1.06 (reducing the tax from $1.20 to $.14 or from 48% to 6%). It would show that the foreign tax credit was worth only $.14, or six percentage points. But the heavy tax impact of the depletion allowance, as compared to the foreign tax credit, occurs only because the depletion allowance deductions are computed first.

Thus, it has been argued that if percentage depletion on foreign production were repealed there would be very little revenue gain. This can also be illustrated, using the same example. The selling price of $10.00 minus the $.50 of production cost leaves a taxable income of $9.50 and a tax liability of $4.56. However, this tax liability will be completely offset by the creditable foreign tax of $7. Thus, repealing percentage depletion would have no effect on tax liability in this case.

Similarly, if the tax credit was eliminated but percentage depletion at the posted price retained, only a small tax liability would result in our illustration: from the selling price of $10 allowable deductions would include $2.20 for depletion, $.50 for production costs and $7

for production taxes (now considered as such rather than as income taxes), leaving a taxable income of 30¢ and a tax liability of 14¢.

If the tax law was changed to require that such production taxes be treated as royalties and thus not be eligible for percentage depletion or the foreign tax credit, while retaining percentage depletion in general, an increased tax liability would result. Again turning to our illustration, percentage depletion would be figured on the $10 selling price minus the $7 royalty and the depletion deduction would be 22% of $3.00 or $.66. In this case the tax would be figured as follows: from the selling price of $10 allowable deductions would include $.50 for production costs, $.66 for depletion and $7.00 for royalties, resulting in a taxable income of $1.84 and a tax of $.88. The treatment of foreign taxes in this manner results in a much greater impact on overall tax liability than that of depletion and this approach may more appropriately reflect the impact of the present treatment of foreign taxes on the effective tax rate. However, there is no way to determine this impact from the tax data.

Only if both percentage depletion and the ability to credit foreign taxes were removed would the actual $2.50 profit in this example be taxed at the statutory rate.

Impact of Certain Tax Provisions

DEPLETION

Table 3 compares the depletion claimed by the entire oil industry to that claimed by the seven oil companies studied. These data indicate that the seven oil companies account for about 60% of the total depletion deductions claimed in the oil industry in the years for which such comparative data were available. The three companies with the largest deductions account for over one-third of the total depletion deductions claimed.

Table 3 only compares total depletion deductions and does not indicate the value of the excess of percentage over cost depletion, which is the actual subsidy value of percentage depletion. The last Internal Revenue Service survey of depletion [5] taken indicates that percentage depletion is about sixteen times cost (or that cost depletion is about 6% of total depletion deductions). However, one might expect that this factor would be relatively lower for large international oil companies who are likely to have older, higher production wells, particularly in the case of foreign production. Smaller companies may be more involved in risky, high cost wells. The data of the seven oil companies indicate that while the percentage varies by company and year, on the average, cost depletion is slightly over 3% of total depletion deductions. This suggests that the actual percentage share of the benefits of depletion deductions, as reflected in Table 3, are somewhat understated.

TABLE 3.—DEPLETION DEDUCTIONS CLAIMED

[Money amounts in thousands of dollars]

	1968	1969	1970	1971	1972
7-company aggregate	$2,187,567	$2,144,858	$1,968,912	$2,298,866	$2,390,723
Oil industry	$3,559,942	$3,716,761	$3,461,248	$4,016,494	NA
7-company aggregate as a percent of total oil industry	61.45	57.71	56.88	57.23	NA

FOREIGN TAX CREDIT

The foreign tax credit is a general provision available to all industries. Table 4 indicates the tax savings to the seven oil companies resulting from the foreign tax credit and compares them to overall savings for 1968 and 1971 for both the oil industry and all corporations. (Only 1968 and 1971 statistics are available for the oil industry and all corporations.) This table indicates that the seven companies accounted for 50% of the tax savings of the oil industry in 1968 and 40% in 1971. They accounted for about 15% of the total foreign tax credit savings for all United States corporations in both years.

[5] Internal Revenue Service, Statistics of Income, 1960, Depletion Allowances.

TABLE 4.—VALUE OF THE FOREIGN TAX CREDIT [1]

[Money amounts in millions of dollars]

	1968	1971
7-company aggregate	$230	$332
Oil industry	$468	[2] $829
All corporations	$1,463	[2] $2,156
7-company aggregate as a percent of the oil industry	49.15	40.05
7-company aggregate as a percent of all corporations	15.72	15.40

[1] This estimate does not include the revenue loss from the exemption for gross-up for less developed country corporations. The Treasury Department estimated this loss to be $55,000,000 for 1968 and $75,000,000 for 1971. (Estimates of Federal tax expenditures, Committee on Ways and Means. Prepared by the staffs of the Treasury Department and Joint Committee on Internal Revenue Taxation, June 1, 1973). Most of this cost would be expected to derive from corporations other than oil and gas corporations.

[2] Estimated. (Source: Energy taxation: possible modifications in the tax treatment of foreign oil and gas income. Prepared by the staff of the Joint Committee on Internal Revenue Taxation, Feb. 24, 1974.)

The estimated value of the credit for the entire oil industry rose faster than that of all corporations and also that of the seven companies. It is difficult to explain this trend unless more oil companies other than the seven companies studied are expanding foreign operations, and particularly into non-oil operations. One would generally expect the trend for foreign oil operations to be a declining value for the tax credit since the companies are already subject to foreign production taxes higher than the United States rate (which makes the value of deducting the taxes greater in relation to the foreign tax credits taken).

Two general factors should be noted in regard to this table. First, although there is a substantial case for viewing the foreign tax credit as a subsidy in the case of oil companies, it is substantially less in the case of other industries. The production taxes are more clearly in the nature of unit taxes rather than income taxes and are paid regardless of profits. As unit taxes they would be passed on in the price of oil. Other foreign taxes (such as those paid in Western Europe) are more clearly in the nature of income taxes.

Secondly, as noted earlier, the nature of income tax reporting understates the actual impact of the foreign tax credit.

Another question which arises in examining the foreign tax credit is to what extent the companies use the per country versus the overall limitation. The per country limitation limits the credit for taxes paid in each country to the amount of the United States tax which would be paid on taxable income from that country. The overall limitation limits the credit for taxes paid in all foreign jurisdictions to the United States tax which would be paid on taxable income in all foreign jurisdictions.

Each limitation has its advantage. If a company has losses in one jurisdiction and profits in another (as measured by United States tax law) then the per country limitation is advantageous, since the losses in one country would reduce taxable income in the other country if an overall limitation were applied. With a per country limitation, this does not occur and furthermore the losses (if the foreign operation is a branch) reduce United States taxable income and United States taxes.

However, there are also advantages, in certain situations, in electing the overall limit. If a company operates in one country which has a tax rate lower than the effective United States rate and in another country which has a tax rate higher than the effective rates, the overall limitation permits the use of excess credits generated in the high tax country to offset United States taxes on taxable income from the low tax country.

The relative advantages of these two limitations can be illustrated with examples.

(1) *Advantage of the per country limitation.*—Assume that a company operates in country A and incurs a $5,000 loss and in country B where it has a $10,000 taxable profit. Assume the rate of taxation is the same as the United States (48%) and $4,800 of tax were paid to country B. If the overall limitation were used, foreign taxable income would be $5,000 (the $10,000 income minus the $5,000 loss) and the limit on the foreign tax credit would be 48% of $5,000 or $2,400. However, if the per country limitation were used there would be no credit for country A (and no taxes paid). However, the limit for country B would be 48% of $10,000 or $4,800. In addition, the $5,000 loss in country A does reduce total taxable income for the company.

(2) *Advantage of the overall limitation.*—Assume that a company operates in country A and country B, having $10,000 of taxable income in each. Assume, however, that country A's taxes were $3,000 and country B's were $6,000. If the per country limitation were used the full $3,000 in country A could be credited, but only $4,800 in country B could be credited for a total of $7,800. If the overall limitation were used total taxable foreign income would be $20,000, the limitation 48% of $20,000 or $9,600 and the full $9,000 of taxes would be credited.

The advantages of the overall limitation and the use of excess tax credits generated from oil production to offset taxes in low tax jurisdictions have received much publicity. However, a report of the Ways and Means Committee [6] suggests that the benefits of the per country limitation are more important for oil companies than the benefits of the overall limitation. The elections of the seven large companies support this view. Out of the seven companies, five used the per country limitation consistently and one used the overall limitation consistently. One company used the per country in 1968 and 1969 and the overall from 1970–72. Three of the companies (using the per country limitation) did have some indications of losses.

These data suggest that the examination of the use of the foreign tax credit should be focused on the use of foreign losses generated in part by the use of the intangible drilling deduction to offset domestic taxable income rather than the use of excess credits to offset United States income taxes on foreign non-oil income. This is the focus adopted by the Oil and Gas Energy Tax Act which would repeal the per country limitation for oil companies and provide recapture of foreign losses. In addition, it suggests that the action taken in the Tax Reform Act of 1969 which limits the use of excess foreign tax credits generated through the percentage depletion allowance to offset taxes on non-mineral income has had little impact.

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[6] House Committee on Ways and Means, Report No. 93-1028, the Oil and Gas Energy Tax Act of 1974, May 4, 1974.

WESTERN HEMISPHERE TRADE CORPORATION'S DEDUCTION

The creation of a Western Hemisphere Trade Corporation (WHTC) permits a special deduction allowed for United States companies operating primarily in the Western Hemisphere (outside the United States). Although major oil companies operate outside the Western Hemisphere, they can set up domestic subsidiaries which are WHTC's and which are eligible for the deduction. The deduction has the effect of reducing the income tax rate by 14 percentage points (from 48% to 34%).

It has been argued that this provision primarily benefits a few large companies, particularly those in the extractive and sales industries and that most other corporations prefer to take advantage of deferral by setting up a foreign subsidiary. The reason that the WHTC provision is attractive in the extractive industries is that percentage depletion is available which would not be the case for its foreign subsidiary. The foreign tax credit is applicable in both cases.

Table 5 compares the WHTC deductions taken by the seven oil companies to those taken by the oil industry and those taken by all corporations. These data indicate that in 1968–1970, the latest years available for comparative purposes, these seven companies accounted for approximately 90% of the WHTC deductions taken by the oil industry and about a third of the total WHTC deductions taken. Furthermore, even among the seven companies, the WHTC deduction is heavily concentrated. For example, the three corporations with the largest WHTC deductions account for about 90% of the seven company total, generally over 80% of the oil industry total and almost one-third of the total for all corporations.

These data support the argument that, in the case of the oil industry at least, the benefits of the WHTC deduction are concentrated in a few companies.

TABLE 5.—WESTERN HEMISPHERE TRADE CORPORATION DEDUCTIONS

[Money amounts in thousands of dollars]

	1968	1969	1970	1971	1972
Aggregate	$129,809	$92,938	$111,080	$155,936	$130,446
Total oil industry [1]	$139,883	$107,679	$122,850	NA	NA
Total all corporations [1]	$390,710	$331,030	$288,959	NA	NA
Aggregate as percent of oil industry	92.80	86.31	90.42	NA	NA
Aggregate as percent of total	33.22	28.08	38.44	NA	NA

[1] From Statistics of Income, Corporation Income Tax Returns.

MINIMUM TAX

The minimum tax on preference income was added as part of the Tax Reform Act of 1969. The minimum tax is imposed at a 10% rate on certain items such as untaxed capital gain, certain accelerated depreciation, stock options and the excess of percentage depletion deductions over the cost basis of the property. From the total of these preference items the taxpayer can deduct regular income taxes paid plus $30,000.

Table 6 illustrates the impact of the minimum tax on the seven companies and compares it with the impact on the oil industry,

primary metals industries, manufacturing industries other than oil and, finally, with all corporations. The data clearly illustrate that the minimum tax has had a much greater impact on the oil industry than on other industries. The table shows that for 1971 the minimum tax, designed to subject previously tax free items to at least some tax, had a significant impact on the seven companies (increased their tax liability by 26.94%) and on the oil industry (increased tax liability by 28.24%) while having little effect overall on all United States corporations (increased tax liability by less than 1%).

TABLE 6.—MINIMUM TAX

[Money amounts in thousands of dollars]

	1970		1971		1972	
	Regular	Minimum	Regular	Minimum	Regular	Minimum
Aggregate	$385,244	$89,326	$368,277	$99,217	$347,502	$103,483
Oil industry [1]	536,751	154,396	536,286	151,425	NA	NA
All corporations [1]	27,612,829	265,249	29,564,351	265,114	NA	NA
Primary metals [1]	397,725	16,483	328,916	16,124	NA	NA
Manufacturing [1] (excluding oil)	12,603,230	40,695	14,086,478	38,968	NA	NA

[1] Statistics of Income, Corporation Income Tax Returns.

TABLE 6 (continued).—PERCENTAGE INCREASE IN TAX LIABILITY DUE TO MINIMUM TAX

	1970	1971
7-company aggregate	23.19	26.94
Oil industry	28.76	28.24
All corporations	.96	.90
Primary metals	4.14	4.90
Manufacturing (excluding oil)	.32	.28

There has been some suggestion that the minimum tax had a lesser impact on larger companies which were more likely to generate regular taxable income which would shield excess depletion from the minimum tax. Initially, the data supports such an argument. If we exclude the seven large companies from the oil industry aggregate, the minimum tax increased taxes of other companies by 43.1% in 1970 and 31.1% in 1971 while it increased the taxes of the seven company aggregate by 23.2% and 26.9% respectively. However, the companies themselves show substantial variations as to relative size of the minimum tax as compared to regular taxes. These data suggest that while the minimum tax has differential impacts on different companies, this differential does not appear to be related to company size.

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