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COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

SUMMARY OF THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1979 (H.R. 3919)

As Reported



JUNE 27, 1979

Prepared by the staffs of the Joint Committee on Taxation
and the Committee on Ways and Means

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(II)

PREFACE

This pamphlet describes the Crude Oil Windfall Profit Tax Act of 1979 (H.R. 3919), as reported by the Ways and Means Committee. Part I summarizes the windfall profit tax and energy trust fund. Part II presents the revenue effects of the bill.

(III)

I. SUMMARY OF BILL

Overview

The committee bill, H.R. 3919, the "Crude Oil Windfall Profit Tax Act of 1979," imposes a 70-percent windfall profit tax on increases in domestic crude oil prices resulting from the deregulation of crude oil prices or from excessive increases in world oil prices. This tax will reduce the profits of oil producers and royalty owners; it will not be passed on as higher prices to consumers. Revenues from the tax will be placed in an energy trust fund to finance programs for dealing with the energy problem. Amounts in the trust fund will be available for purposes to be specified by law at a later date, subject to the usual authorization and appropriations process.

The tax will raise \$2.8 billion in calendar year 1980, \$5.7 billion in 1981 and \$7.1 billion in 1982. In fiscal year 1980, the revenue raised will be \$2.0 billion.

Windfall Profit Tax

The windfall profit tax is an excise, or severance, tax applying to all crude oil produced in the United States according to its classification in one of three tiers. Essentially, the tax structure is the same for the three tiers except that each tier has a different base price above which price increases are subject to tax.

Tier one tax

For oil in tier one, the tax is 70 percent of the difference between the actual selling price of the oil and the May 1979 lower tier, or old oil, ceiling price (which averaged just under \$6 per barrel), adjusted for inflation.

The tier one tax applies to oil which would have been controlled as lower tier oil if the pre-June 1979 price controls had been continued but which receives a higher price as a result of decontrol. This tier includes oil from "marginal" properties, which were given special treatment under the President's decontrol program.

The quantity of oil subject to the tier one tax on a property is the amount of production from the property below an amount represented by a statutory decline curve. This decline curve initially equals the average daily production of lower tier oil from the property in the period October 1978–March 1979. This base is reduced by 1½ percent per month beginning January 1979. This decline rate causes the tier one tax to phase out after July 1984. By July 1984, all of this oil will be taxed in tier two; that is, on price increases above the inflation-adjusted upper tier ceiling price, rather than the lower-tier ceiling price, which is the base for the tier one tax.

Tier two tax

The tier two tax is 70 percent of the difference between the actual selling price and the May 1979 upper tier, or new oil, ceiling price (which averaged just over \$13 barrel), adjusted for inflation. It is a permanent tax under the committee bill.

The tier two tax applies to oil produced on a property in excess of the amount indicated by the tier one decline curve. Thus, the tier two tax base will include most oil which had been controlled as upper tier oil prior to the decontrol program (generally, oil discovered between 1972 and 1979) as well as oil released to tier two through the 1½-percent monthly decline curve. Because of the decline curve, *increases* in production on old properties resulting from additional drilling, secondary recovery or other methods generally will be taxed under the more lenient tier two tax. This tier also includes oil released from the lower tier to the upper tier of price controls to provide "front end financing" for tertiary recovery projects.

Tier three tax

The tier three tax is 70 percent of the difference between the actual selling price of the oil and \$16 per barrel, adjusted for inflation and for differences in quality and location. Special 50-percent rates apply to taxable Alaskan North Slope oil and to the first \$9 of windfall profit on newly discovered oil.

The tier three tax applies to newly discovered oil, stripper oil, taxable Alaskan North Slope oil, oil produced on the Naval Petroleum Reserve, and certain oil produced on properties on which the producer uses qualifying tertiary recovery methods.

To provide the appropriate production incentives, the bill provides special treatment for newly discovered oil, certain Alaskan oil, and incremental oil production from qualified tertiary recovery projects.

Newly discovered oil is taxable in tier three, but only to the extent its selling price exceeds a \$17 base price (instead of \$16). In addition, the first \$9 of windfall profit on newly discovered oil is taxable at a 50-percent rate (instead of 70 percent), and the inflation adjustment to its base price and to the \$9 of windfall profit eligible for the 50-percent rate is set 2 percentage points above the generally applicable inflation rate. However, the bill contains a more restrictive definition of newly discovered oil than the one used for price controls.

Oil from the Sadlerochit reservoir in Alaska, which is now producing a large volume of oil, is taxed in the third tier, but at a 50-percent rate (instead of 70 percent). The base price for Sadlerochit oil is \$7.50 per barrel (compared to an average wellhead price of \$5.22 in 1978), adjusted upward for inflation and upward to the extent of any reductions in the real value of the Trans-Alaskan Pipeline System tariff. Oil from other Alaskan reservoirs located North of the Arctic Circle, including those already discovered but not yet developed, is exempt from the windfall profit tax.

A portion of oil produced on a property on which the producer uses qualifying tertiary recovery techniques is taxed in tier three instead of one of the first two tiers. This portion equals the amount of production in excess of a decline curve which initially is based on a decline rate of one percent per month but which accelerates to 2½ percent per month when use of the tertiary recovery process begins.

Rules applicable to all three tiers

For oil subject to the 70-percent rate, the windfall profit subject to tax is reduced by the State severance taxes on the windfall profit.

To prevent the tax from burdening high-cost properties, the bill also limits the windfall profit subject to tax to 100 percent of the net income from a property.

Income from interests in oil production owned by State or local governments, or by public educational institutions, is exempt if the income is dedicated to public education.

The windfall profit tax is a deductible business expense under the income tax. In addition, gross income for purposes of determining percentage depletion is reduced by the amount of windfall profit.

The windfall profit tax also contains a number of provisions designed to aid taxpayers and the Internal Revenue Service in the administration and enforcement of the tax.

While the windfall profit tax is structured to be consistent with the proposed deregulation of crude oil prices, it is not contingent on decontrol and will apply even if some form of price controls were continued or reimposed.

Trust Fund

The revenues from the windfall profit tax are to be deposited in an Energy Trust Fund created by the bill. The purposes for which money may be spent from the trust fund will be specified in future legislation.

Effective Date and Study

The windfall profit tax is effective January 1, 1980. By January 1, 1983, the President is required to submit to Congress a study of the effects of both oil price decontrol and the windfall profit tax.

II. REVENUE EFFECTS

Table 1 shows the revenue effects of H.R. 3919 as reported by the committee, in the years 1980 to 1984. These estimates of the net revenue raised by the tax take into account both the gross windfall profit tax and the reduction in corporate and individual income tax receipts resulting from imposition of the windfall profit tax.

The net revenue raised by the windfall profit tax is expected to be \$2.8 billion in calendar year 1980, \$5.7 billion in 1981, and \$7.1 billion in 1982. In fiscal year 1980 the increase in receipts is expected to be \$2.0 billion.

Table 2 shows the revenue impacts of the principal amendments adopted by the Ways and Means Committee to the original Administration proposal (essentially H.R. 3919 as introduced). In each case, the revenue effect of a particular amendment is shown as if all other amendments had been adopted. Thus, the estimates for each amendment do not take into account the interaction between amendments (e.g., the revenue effect of an increase in the tax rate from 50 percent to 70 percent is larger if another amendment has increased the tax base). For the sum of the estimates of the revenue impacts of each of the particular amendments to equal the overall difference between the committee's bill and the Administration proposal, there has to be a separate entry in the table to account for the interaction among amendments.

Table 1.—Estimated Revenue Raised by H.R. 3919, as Amended

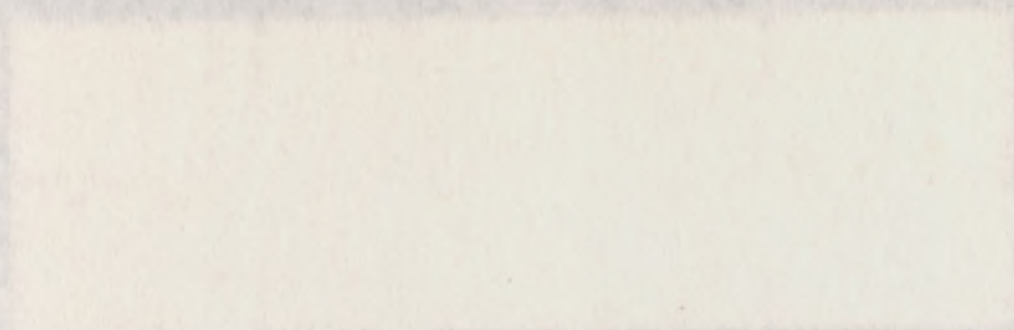
[In millions of dollars]

	1980	1981	1982	1983	1984
Calendar year-----	2, 810	5, 723	7, 136	6, 846	6, 600
Fiscal year-----	1, 953	5, 054	7, 682	6, 922	6, 517

Table 2.—Estimated Revenue Effects of Principal Committee Changes to H.R. 3919 as Introduced

[In millions of dollars]

	Calendar year—				
	1980	1981	1982	1983	1984
H.R. 3919 as introduced (Administration proposal)-----	1, 576	3, 919	5, 097	5, 072	5, 516
Amendments:					
Reduction in tier 1 decline curve from 2 percent to 1½ percent--	+117	+336	+579	+653	+111
Rate increase from 50 to 70 percent-----	+596	+1, 264	+1, 579	+1, 495	+1, 414
Marginal oil put in tier 1-----	+639	+512	+365	+199	+42
Alaskan oil taxed in tier 3-----	+209	+254	+312	+377	+451
Special rules for newly discovered oil-----	-77	-181	-346	-599	-953
2½-percent decline curve for tertiary oil-----	-10	-36	-78	-97	-104
Exemption for State and local royalties-----	-137	-247	-308	-314	-322
Interaction among amendments-----	-103	-98	-64	+60	+445
Total effect of committee amendments-----	+1, 234	+1, 804	+2, 039	+1, 774	+1, 084
H.R. 3919, as amended-----	2, 810	5, 723	7, 136	6, 846	6, 600





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