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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 Passed by the House of Representatives

on

June 28, 1979

JULY 3, 1979

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

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PREFACE

This pamphlet describes the Crude Oil Windfall Profit Tax Act of 1979 (H.R. 3919), as passed by the House of Representatives on June 28, 1979. Part I summarizes the windfall profit tax and energy trust fund. Part II presents the revenue effects of the bill.

I. SUMMARY OF H.R. 3919 AS PASSED BY THE HOUSE

Overview

H.R. 3919, the "Crude Oil Windfall Profit Tax Act of 1979," (as passed by the House on June 28, 1979) imposes a 60-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 would reduce the profits of oil producers and royalty owners; it would not be passed on as higher prices to consumers. Revenues from the tax would be placed in an energy trust fund to finance programs for dealing with the energy problem. Amounts in the trust fund would be available for purposes to be specified by law at a later date, subject to the usual authorization and appropriations process.

The tax would raise $3.7 billion in calendar year 1980, $7.7 billion in 1981 and $9.7 billion in 1982. In fiscal year 1980, the revenue raised would be $2.5 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 60 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 does not include 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 60 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. The tier two tax is to be phased out between November 1986 and the end of 1990 by increasing the adjusted base price of upper tier oil to the tier three base price. After 1990, this oil will continue to be taxed in the same manner as tier three oil.

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 lower 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 would 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, and production from "marginal properties." 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.

Tier three tax

The tier three tax is 60 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 and on the incremental production from qualified tertiary projects.

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.

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 60 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. After 1990, newly discovered oil is exempt entirely.

Oil from the Sadlerochit reservoir in Alaska, which is the only North Slope reservoir now in production, is taxed in the third tier, but at a 50-percent rate (instead of 60 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 teritary 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.

Incremental tertiary production is taxed in tier three, but only to the extent that its selling price exceeds a $17 base price (instead of $16). In addition, the first $9 of windfall profit on incremental tertiary oil is taxable at a 50-percent rate (rather than at a 60-percent rate), 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 adjustment. After 1990, incremental tertiary oil is exempt entirely.

Rules applicable to all three tiers

For oil subject to the 60-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 interest 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 effect of the House-passed windfall profit tax. This includes the gross amount of revenue raised by the windfall profit tax itself and the offsetting reduction in corporate and individual income taxes resulting from imposition of the windfall profit tax. Income taxes change mainly because the windfall profit tax is deductible, because it reduces deductions for oil drilling, and because it reduces oil production and, therefore, taxable income of producers and royalty owners. Also, income taxes increase in response to the windfall profit tax because the House bill denies percentage depletion on the gross income considered windfall profit. This increase is shown separately in table 1.

Table 2 shows the effect of the windfall profit tax on fiscal year tax receipts.

The revenue estimates are highly sensitive to the assumed world oil price. It is assumed that the wellhead price of uncontrolled oil is $22 in the third quarter of 1979 and that it increases at the rate of inflation plus one percent per year. This $22 price is approximately what will result from the recent OPEC price increases.

Table 1.—Calendar year revenue effect of House-passed windfall profit tax

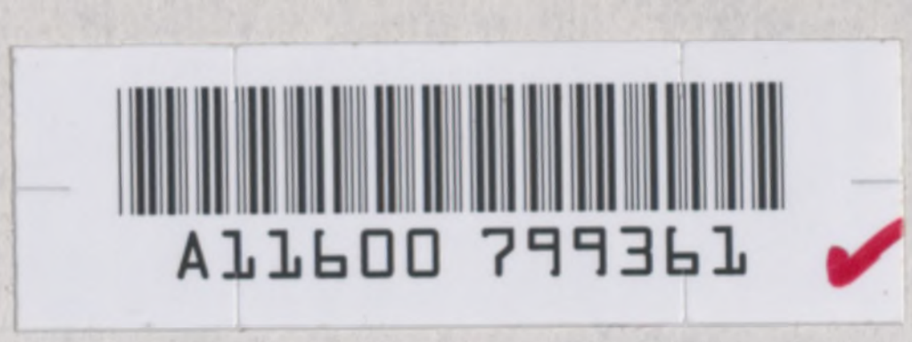
[In millions of dollars]

	1980	1981	1982	1983	1984
Gross windfall profit tax	6,118	12,901	16,459	16,672	16,884
Reduction in income taxes	−2,591	−5,571	−7,197	−7,409	−7,644
Tax increase from disallowing depletion on windfall profit	180	380	445	400	379
Net windfall profit tax	**3,708**	**7,710**	**9,708**	**9,663**	**9,619**

Table 2.—Fiscal year revenue effect of House-passed windfall profit tax

[In millions of dollars]

	1980	1981	1982	1983	1984
Gross windfall profit tax	3,504	10,251	15,838	16,214	16,292
Reduction in income taxes	−1,099	−3,909	−6,290	−7,291	−7,513
Tax increase from disallowing depletion on windfall profit	80	269	409	425	390
Net windfall profit tax	**2,485**	**6,610**	**6,956**	**9,349**	**9,170**


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