REVENUE EFFECTS OF THE CRUDE OIL WINDFALL PROFIT TAX ACT (P.L. 96-223)

Report
Prepared at the Request of
Subcommittee on Oversight and Investigation
Committee on Interior and Insular Affairs
U.S. House of Representatives

May 1983

Congressional Budget Office
Congress of the United States

This report was prepared by James Nason of the Tax Analysis Division, under the direction of James M. Verdier. Questions regarding the analysis may be addressed to them at 226-2680.

REVENUE EFFECTS OF THE CRUDE OIL WINDFALL PROFIT TAX ACT (P.L. 96-223)

One of the provisions of the Crude Oil Windfall Profit Tax Act imposed a windfall profit tax on domestically produced crude oil. The tax is actually an excise or severance tax on crude oil produced after February 29, 1980. The act defined three categories of oil to be taxed. Tier one oil consists of all domestically produced oil not explicitly placed in either tier two, tier three, or exempted from the windfall profit tax. Tier two includes oil produced from a stripper well property and oil from the Naval Petroleum Reserve. Tier three oil is composed of newly discovered oil (discovered after 1978), heavy oil, and incremental tertiary oil (oil produced using specifically defined recovery techniques).

Initial projections of the gross and net fiscal year receipts and calendar year liabilities were produced at the time that the windfall profit tax was passed in April 1980.[1] These projections, reproduced from the Crude Oil Windfall Profit Tax Act of 1980 Conference Committee Report, appear in Tables 1 and 2 (attached). The projections shown in Tables 1 and 2 rely upon forecasts of crude oil prices made at that time.

The latest CBO projections of the windfall profit tax appear in Table 3. These estimates of gross fiscal year unified budget receipts are much lower than those prepared for the Conference Committee report at the time the windfall profit tax was passed. The newer projections range from about 40 percent of the Conference Report estimate for gross fiscal year 1983 receipts to about 20 percent for gross fiscal year 1988 receipts. There are two reasons for this. First, the price of crude oil has been lower over the last three years than projected at the time of the Conference Committee Report. The price of crude oil is projected at this time to continue to be lower over the next five years than was projected in the Conference Committee report. Lower crude oil prices mean lower crude oil windfall profit taxes, everything else being equal, because the tax is based on the difference between the baseline regulated price (indexed for inflation) and the decontrolled price.

In addition, the Economic Recovery Tax Act (P.L. 97-34) exempted stripper oil produced by independent producers, extended and increased the credit and exemptions for royalty owners, reduced the windfall profit tax rate on newly discovered oil,

---

1. Net windfall profit tax receipts are lower than gross receipts because they reflect the reduction in income tax receipts that results because windfall profit taxes are a deductible business expense.

and exempted certain child-care organizations from the windfall profit tax. Further, the Technical Corrections Act of 1982 (P.L. 97-448) extended the royalty holder barrel-per-day exemption to certain trust arrangements. These credits, exemptions, and reduced rates have been estimated to reduce gross windfall profit tax revenue by approximately $1.2 billion in fiscal year 1983 and $1.4 billion in fiscal year 1988.

Monthly receipt figures to date for the crude oil windfall profit tax have not been published and are not available from the Treasury Department; however, quarterly tax liability figures are available and appear in Table 4.

Revenue Effects of a Windfall Profit Tax on Natural Gas

Any proposed windfall profit tax on natural gas decontrolled under the Natural Gas Policy Act (P.L. 95-621, NGPA) in 1985, or under future decontrol legislation would differ from a comparable oil tax in terms of both administrative feasibility and incidence (i.e., the structure and information requirements of the tax, who pays the tax, and how it affects gas prices). The Crude Oil Windfall Profit Tax requires detailed information on each individual oil-producing property in the United States, including its production volume and the tier or class of oil produced by each well, as stipulated in the Crude Oil Windfall Profit Tax Act. Indeed, enforcing the tax requires this information. On the other hand, detailed data on volume and price for each "non-associated" gas-producing well have not been systematically collected. The composition of gas supply in terms of old and new gas can only be inferred from private surveys and producers reporting to the Federal Energy Regulatory Commission as required by the NGPA. Hence, it may be impracticable to apply a complex natural gas windfall profit tax--information limitations may compel using a simple excise tax on all gas.

The incidence of a windfall profit tax on gas would also be different from that of a windfall profit tax on oil. In the case of oil, large import levels have forced domestic producers to absorb the entire burden of the tax. If oil producers were to try to pass the tax forward, refiners would simply replace domestic crude with imported crude. This compels domestic producers to pay the tax out of their profits. In the case of gas, however, import levels are small and prices are high. Gas pipelines would not switch to imports unless the tax drove the domestic price above the import price, or unless foreign producers cut their prices.

If the Congress chose to tax only some portion of the gas market--for example, old gas discovered before April 1977--and to allow other types of gas to go untaxed, a complete passthrough of the tax to consumers could be averted. In this case, the tax on old gas would curtail a pipeline firm's ability to minimize the overall price of gas charged to its customers by mixing less expensive old gas with higher-cost gas. This would force the pipeline firm to bear at least part of the tax. On the other hand, if pipeline firms could renegotiate their high-cost gas contracts to obtain

lower prices then producers of high-cost gas would pay part of the tax. Present contracts, with their high-cost take-or-pay provisions and lack of market-out clauses that would enable a pipeline firm to negate its contract, prevent downward adjustment in these gas categories. Legislative action on contract provisions would probably be necessary to free the pipeline firms from such restrictions. Moreover, the gap between the average price for old gas of $1.25 per million cubic feet and the average price for new gas--gas discovered after April 1977--of $3.35 is large and, unless fully offset by a tax, would still leave producers room to pass the tax through to consumers. Further, a tax on old gas would encourage producers to "shut-in" -- stop production on -- their old gas wells and try to qualify for higher-priced incentive categories under the Natural Gas Policy Act.

TABLE 1. CONFERENCE REPORT ESTIMATE OF CRUDE OIL WINDFALL PROFIT TAX, FISCAL YEAR RECEIPTS (March 1980, in millions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Gross Windfall Profit Tax	5,159	20,955	32,293	35,124	37,429	39,525	40,923	42,524	44,181	46,270	48,538
Net Windfall Profit Tax	3,172	13,436	19,543	19,958	21,144	22,227	22,776	23,601	24,423	25,593	26,772

TABLE 2. CONFERENCE REPORT ESTIMATE OF CRUDE OIL WINDFALL PROFIT TAX, CALENDAR YEAR LIABILITY (March 1980, in millions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Gross Windfall Profit Tax	10,876	25,952	33,534	35,952	38,202	40,104	41,445	43,185	44,789	47,049	49,399
Net Windfall Profit Tax	6,306	14,719	18,875	20,147	21,312	22,267	22,907	23,778	24,588	25,771	27,017

TABLE 3. CBO ESTIMATE OF CRUDE OIL WINDFALL PROFIT TAX, GROSS FISCAL YEAR RECEIPTS (In millions of dollars)[a]

Actual										
1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
5,959	23,290	18,881	13,826	13,499	12,195	10,327	9,619	8,996	NA	NA

a. Based on CBO economic assumptions. See The Outlook for Economic Recovery (February 1983). Includes technical reestimates for April 1983 update. Currently, the CBO does not have available net fiscal year windfall profit tax receipts. Net windfall profit tax receipts are lower than gross receipts because they reflect the reduction in income tax receipts that results because windfall profit taxes are a deductible business expense.

NA = Not Available.

TABLE 4. TAX LIABILITY BY QUARTER--AFTER ADJUSTMENTS--SINCE THE INCEPTION OF THE CRUDE OIL WINDFALL PROFIT TAX (In millions of dollars)

Quarter Ending				
March 1980	June 1980	September 1980	December 1980	March 1981
788	2,821	3,325	2,991	7,195
June 1981	September 1981	December 1981	March 1981	June 1981
7,149	6,093	5,510	5,001	3,988

SOURCE: Department of the Treasury, Statistic of Income (Spring 1983).