# Windfall Profit Tax, 1980-81

By Phil Clark*

Windfall profit tax liability after adjustments for the first quarter of 1981 amounted to approximately $7.1 billion, according to preliminary data. This represents almost 42 percent of the total liability reported since the tax went into effect in 1980. This large increase in quarterly tax liability is due in part to the decontrol of crude oil prices as of January 1981.

The table below provides a summary of tax liability by quarter since the inception of the windfall profit tax. First quarter 1981 figures continue a trend in which the liability before adjustments has increased in each quarter since the enactment of the tax. The statistics show that adjustments had a net positive effect on tax liability in the first quarter of 1981 for the first time. First quarter 1981 adjustments represent, in large part, a 1980 year-end account balancing by withholding agents.

| | Millions of Dollars | | |
|---|---|---|---|
| Quarter Ending | Tax Before Adjustments | Adjustments | Tax After Adjustments |
| Total..... | 17,852 | -786 | 17,066 |
| March 1980 1/... | 788 | - | 788 |
| June 1980....... | 2,842 | -21 | 2,821 |
| September 1980.. | 3,413 | -88 | 3,325 |
| December 1980... | 3,918 | -927 | 2,991 |
| March 1981...... | 6,891 | +250 | 7,141 |

1/ One month only.

THE TAX

The Crude Oil Windfall Profit Tax Act of 1980 imposed a Federal excise tax on domestic crude oil extracted on or after March 1, 1980. The windfall profit per barrel is the removal price of a barrel of oil less the sum of the adjusted base price and the State severance tax adjustment applicable to that barrel. The base price for this computation is determined by a method set forth in the Act (see Definitions). The adjusted base price is the base price multiplied by a quarterly inflation adjustment factor [1], which is computed by the Internal Revenue Service (IRS). The windfall profit tax is the windfall profit times the appropriate tax rate.

The tax rate varies with the classification of the taxable crude oil into one of three tiers. In addition, for independent producers (generally a producer not involved in the refining or retailing of oil) lower rates are allowed on the first 1,000 barrels per day of tier one and tier two oil attributable to working interests. Following are the tax rates applicable for each category of oil:

| Type of Oil | General Rates | Independent Producer Rates |
|---|---|---|
| Tier 1-- All nonexempt domestic oil except Tier 2 and Tier 3 oil............... | 70% | 50%* |
| Tier 2-- Stripper oil and oil produced from a National Petroleum Reserve.................. | 60% | 30%* |
| Tier 3-- Newly discovered oil, heavy oil and incremental tertiary oil....... | 30% | 30% |

* First 1,000 barrels per day.

The tax is imposed on the holders of the economic interest, the producers; however, for taxpayers other than integrated oil companies the tax is withheld and paid by the first entity buying the crude oil, known as the first purchaser, or by a qualified intermediary. This process of withholding and paying the tax is similar to the way an employer withholds income and social security tax from an employee. Integrated oil companies deposit the tax on their own production. The total number of withholding entities for 1980 was between 800 and 900, although the number for any one quarter never reached that total, due to shifts in the filing population from quarter to quarter.

Should under- or over-withholding occur, the depositing or withholding agent is responsible for correcting that error to the extent possible by adjusting the amounts withheld in succeeding quarters. In addition, the net income limitation provision of the Act limits the windfall profit to 90 percent of the net income per barrel of oil. Overpayment due to the application of the net income limitation may be accounted for currently on a quarter-by-quarter basis.

Additional information about the windfall profit tax provisions may be found in the Fall 1981 SOI Bulletin. [2]

EXEMPT OIL

The Act allows five specific types of oil production to be exempt from the windfall profit tax. Because filers were not required to supply information on exempt oil in 1980, this is the first report

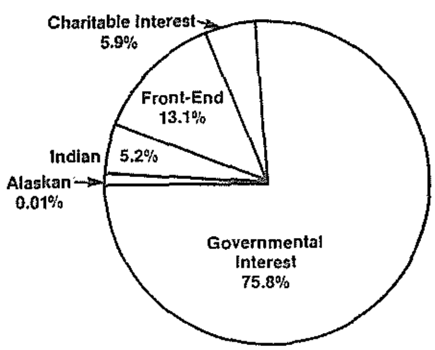
*Special Studies Section. Prepared under the direction of Michael Coleman, Windfall Profit Tax Team Leader, and Paul Grayson, Chief, Special Studies Section.

on this type of production. In total, filers reported production of 17.1 million barrels of exempt oil in the first quarter of 1981.

In general, the five types of exempt production are: a) oil produced by State and local governments, the net income from which is used for public purposes; b) oil produced by charitable medical and educational institutions, or by a church if the net proceeds are dedicated to such an institution; c) oil produced by certain qualified Indian tribes or individuals; d) oil produced in certain remote areas of Alaska; and e) certain oil deregulated by the Department of Energy to be used to finance a tertiary recovery project ("exempt front-end oil"). For a more detailed discussion of these terms, see Definitions.

The distribution of exempt oil among the five types, for those returns which included such information for the first quarter of 1981, is as follows:

Exempt Oil




BASIC TABLE INFORMATION

Shown in Table 1 is the tax liability before adjustments by tier and tax rate for the quarter ending March 31, 1981, and for the entire period since the tax took effect, March 1, 1980, through March 31, 1981. Also shown are the components of the windfall profit for the entire period as reported on returns showing these items. Table 2 shows the volume of exempt oil classified by type of exemption and by tier of oil.

The 1981 data in these tables are from returns received through September 1981. Delinquent returns and amended returns, as well as adjustments to liability reported in subsequent quarters, may result in revisions to these tables. Revisions are not yet available for 1980 data.

Following these tables is a description of the source of the data and selected definitions.

DATA SOURCES AND LIMITATIONS

The Quarterly Federal Excise Tax Return, Form 720, is the form on which the windfall profit tax is reported. The windfall profit tax is only one of more than 20 excise taxes reported on that form. Form 6047, Windfall Profit Tax, shows how the tax is computed and is filed as an attachment to Form 720. Returns are due two months after the end of the quarter in which the oil is removed.

The data for the first quarter of 1981 are based only on returns with a tax liability of $1 million or more before adjustments. In the last three quarters of 1980 (the tax took effect in March 1980, and thus the first quarter of 1980 contained only one taxable month) returns falling in this liability range accounted for 98.3 percent of the liability. Data for 1981 have been adjusted upward to estimate the total liability and barrels of oil. Data in Table 1 for 1980 are based on all returns filed through mid-summer 1981.

The Internal Revenue Service also releases windfall profit tax statistics in a quarterly report on all excise tax collections [3]. A number of considerations affect comparison of data from these two sources. The excise tax collection figures show the liability after adjustments, as reported on Form 720, of returns entered into the IRS' computerized Business Master File (BMF) each quarter. Returns are not due until two months after the close of the taxable quarter; consequently, the report for the third quarter of 1980, for instance, shows amounts attributable to liabilities accrued for oil removed in the first and second quarter of 1980. Furthermore, the interval between the close of the taxable period and the final recording of the return often varies, so that the quarterly BMF totals can represent several taxable periods. On the other hand, the data presented here have been tabulated for specific taxable periods. As a result, the two sets of statistics are not directly comparable.

Since no statistical sampling was involved, the data in this report are not subject to sampling error. The data, however, are subject to nonsampling error. There may be errors as a result of the extrapolation of all figures to account for the 1.7 percent of the population not tabulated. In addition, although attempts were made to secure all returns filed, some returns may have been omitted due to time and resource constraints. Attempts were also made to correct imbalances in taxpayer entries concerning the components of windfall profit; if this proved impossible, an out-of-balance return was treated as a return on which the components were not reported, and therefore only the liability for each tier was tabulated. A number of verification checks were performed at all stages of manual data abstraction and tabulation.

Table 1.--Windfall Profit Tax Liability by Oil Tier and Tax Rate for the Quarter Ended March 31, 1981; Components of Windfall Profit Cumulative from March 1, 1980, to March 31, 1981

[Money amounts are in millions of dollars]

| Oil tier and tax rate | Tax liability before adjustments | | Returns with components of windfall profit cumulative from March 1, 1980, to March 31, 1980[1] | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Quarter ended March 31, 1981 | Cumulative from March 1, 1980, to March 31, 1981 | Number of barrels of oil (000's) | Removal value | Adjusted base value | State severance tax adjustment | Windfall profit | Tax liability before adjustments |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| All returns, total | 6,891 | 17,852 | 751,249 | 22,467 | 11,133 | 594 | 10,740 | 6,094 |
| Returns with tax liability shown by oil tier and tax rate: Total | 6,546 | 15,402 | 751,249 | 22,467 | 11,133 | 594 | 10,740 | 6,094 |
| Tier one, other than Sadlerochit oil: | | | | | | | | |
| Taxed at 70 percent | 4,691 | 9,506 | 396,729 | 11,367 | 5,487 | 322 | 5,558 | 3,892 |
| Taxed at 50 percent | 306 | 620 | 45,309 | 1,242 | 643 | 34 | 565 | 282 |
| Tier one, Sadlerochit oil: | | | | | | | | |
| Taxed at 70 percent | 313 | 959 | 31,837 | 736 | 452 | 30 | 254 | 178 |
| Taxed at 50 percent | 21 | 32 | 822 | 31 | 11 | 4 | 16 | 8 |
| Tier two oil: | | | | | | | | |
| Taxed at 60 percent | 612 | 2,327 | 79,557 | 2,848 | 1,345 | 69 | 1,434 | 860 |
| Taxed at 30 percent | 194 | 679 | 56,727 | 2,115 | 982 | 44 | 1,089 | 326 |
| Tier three oil (taxed at 30 percent): | | | | | | | | |
| Newly discovered oil | 313 | 930 | 104,446 | 3,209 | 1,658 | 87 | 1,464 | 440 |
| Incremental tertiary oil | 12 | 21 | 2,348 | 83 | 45 | 1 | 37 | 11 |
| Heavy oil | 84 | 329 | 33,474 | 836 | 510 | 3 | 323 | 97 |
| Total returns with tax liability not shown by oil tier and tax rates | 345 | 2,450 | - | - | - | - | - | - |

[1]Represents 64.5 percent of all returns tabulated and 34 percent of liability. Filers were not required to report this detail for 1980.
NOTE: Detail may not add to total because of rounding.

Table 2.--Exempt Oil Volume by Tier and Category, Quarter Ended March 31, 1981

[Thousands of barrels]

| | Total | Tier one | Tier two | Tier three | | |
|---|---|---|---|---|---|---|
| | | | | Newly discovered oil | Incremental tertiary oil | Heavy oil |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Total | 17,115 | 14,222 | 1,790 | 926 | 16 | 161 |
| Exempt governmental interest | 12,976 | 11,444 | 652 | 729 | 15 | 136 |
| Exempt charitable interest | 1,008 | 625 | 259 | 113 | 1 | 10 |
| Exempt Indian oil | 885 | 434 | 372 | 77 | - | 2 |
| Exempt Alaskan oil | 2 | - | - | 2 | - | - |
| Exempt front-end oil | 2,244 | 1,719 | 507 | 5 | - | 13 |

Definitions

Brief definitions of many of the terms used in this article are given below. For a more detailed treatment see Reference [4], below.

Adjusted Base Price.--The base price multiplied by the inflation adjustment, which is determined from the "implicit price deflator" derived by the Department of Commerce [1].

Adjustments to Liability.--Corrections applied to the current quarter's liability in order to correct over- and under-withholding in previous quarters.

Base Price.--For tier one oil, the upper tier ceiling price, as defined by Department of Energy price control regulations [5], which would have applied to the oil had it been produced and sold in May 1979, reduced by 21 cents. This is expected to average about $12.81 a barrel. For tier two and three oil, the base prices were approximately $15.20 and $16.55, respectively, adjusted for grade and quality.

Crude Oil.--The term applies only to natural crude petroleum and does not include synthetic petroleum, such as oil from shale or tar sands. It does, however, include natural gas liquids treated as crude oil under the June 1979 energy pricing regulations issued by the Department of Energy.

Exempt Alaskan Oil.--Oil from a reservoir other than the Sadlerochit reservoir that has been commercially exploited by any well north of the Arctic Circle; and oil produced north of the Alaska-Aleutian Range, and at least 75 miles from the nearest point of the Trans-Alaska Pipeline System.

Exempt Charitable Oil.--Oil produced from economic interests held by charitable medical facilities and educational institutions (as defined in Internal Revenue Code section 170), if such interest was held on January 21, 1980, and at all times thereafter; and oil produced from interests held by a church on January 21, 1980, if, prior to January 22, 1980, the net proceeds of such oil were dedicated to the support of a medical facility or educational institution.

Exempt Front-End Oil.--Certain oil that the Department of Energy deregulates to be used to finance a tertiary recovery project (see Tier Three Oil, Incremental Tertiary Oil). For a discussion of the many limitations and exceptions to this exemption, see Reference [4] below. This category of oil no longer existed after January 28, 1981, due to the deregulation of all domestic oil.

Exempt Governmental Oil.--Oil produced from an economic interest held by a State or political subdivision (including agencies and instrumentalities) the net income from which is used for public purposes.

Exempt Indian Oil.--Oil produced from mineral interests held by or on behalf of Indian tribes or individuals on January 21, 1980, which is one of the following three types: (a) production received by Indian tribes and individuals from Tribal Trust Lands (the title of such land is held by the United States in trust for the tribes), (b) production from land or mineral interests held by an Indian tribe eligible for services provided to Indians by the Secretary of the Interior, or (c) oil from which the proceeds are paid into the U.S. Treasury to the credit of tribal or native trust funds pursuant to law. This exemption also applies to production of any Alaska Native Corporation prior to 1991.

First Purchaser.--First entity buying domestic crude oil.

Integrated Oil Company.--Entity that both produces oil and is either a retailer or a refiner.

National Petroleum Reserve.--Located at Point Barrow, Alaska.

Net Revenue.--This equals the gross, or excise, tax (excluding that amount attributable to U.S. Government interests) less the reduction of income tax resulting from taxpayers claiming deductions for windfall profit tax paid. Figures presented in this report are gross liabilities.

Producer.--Holder of an economic interest with respect to crude oil in place. The producer may either have a working interest and share the cost of development and production or have a royalty or other nonworking interest.

Qualified Disburser.--A disburser is an entity which receives payments from the sale of crude oil and is responsible for distributing some or all of these payments to the producers. In general, a qualified disburser must distribute 10 percent or more of the total proceeds, or be an integrated oil company or a Federally-registered partnership.

Removal Price.--Generally, the price for which a barrel of oil is sold. In some instances, a constructive sales price is used.

Sadlerochit Oil.--Crude oil production from the Sadlerochit reservoir in the Prudhoe Bay oil field in Alaska.

State Severance Tax Adjustment.--A State severance tax is a tax imposed by a State with respect to the extraction of oil. The windfall profit is reduced by the amount by which the severance tax exceeds that which would have been imposed had the oil been valued at its adjusted base price.

Stripper Oil.--In general, oil from a property from which the average daily production per well has been 10 barrels or less for any consecutive 12-month period after 1972.

Tier One Oil.--All domestically-produced crude oil other than any oil classified in tiers two or three, or explicitly exempted from the tax by the Act. This includes the bulk of domestic oil from reservoirs proven to be productive before 1979.

Tier Two Oil.--Any oil, other than oil classified in tier three, which is from a stripper well property within the meaning of the June 1979 Department of Energy pricing regulations and oil from a U.S. economic interest in a National Petroleum Reserve.

Tier Three Oil, Heavy Oil.--All crude oil which is (1) produced from property which had a weighted average gravity of 16.0 degrees API [6] or less, corrected to 60 degrees Fahrenheit, for the last month of production prior to July 1979 or (2) oil from a property with a weighted average gravity of 16.0 degrees API or less, corrected to 60 degrees Fahrenheit, for the taxable period.

Tier Three Oil, Incremental Tertiary Oil.--Production in excess of a base level on a property on which a qualified tertiary recovery project (one which utilizes one of several specific chemical, fluid or gaseous recovery methods to extract oil not recoverable using standard techniques) has been undertaken. The non-incremental oil (i.e., the amount of production up to the base level) remains in the otherwise applicable tier.

Tier Three Oil, Newly Discovered Oil.--Crude oil that is sold after May 31, 1979, and that 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 on-shore property developed after Calendar Year 1978.

References

[1] The inflation adjustment, calculated by the Statistics Division, is published quarterly in the Internal Revenue Bulletin. (See for example IRS Bulletin 1981-24, dated June 15, 1981.)

[2] U.S. Department of Treasury, Internal Revenue Service, SOI Bulletin, Volume I, Number 2, Publication 1136, U.S. Government Printing Office, 1981.

[3] "Internal Revenue Collections of Excise Taxes," released quarterly by the Internal Revenue Service.

[4] Joint Committee on Taxation (Staff), General Explanation of the Crude Oil Windfall Profit Tax Act of 1980, U.S. Government Printing Office, 1981

[5] The pricing regulations were most recently published in 46 Federal Register 20512, April 3, 1981.

[6] A discussion of the API (American Petroleum Institute) degree gravity scale, used to indicate the density of crude oil, can be found in API Technical Data Handbook-Petroleum Refining, Volume I, Chapter 6. The higher the API gravity, the lighter the oil. The normal range is 27 degrees to 40 degrees.

*U.S. GOVERNMENT PRINTING OFFICE: 1982-0-361-544/5460