Crude Oil Windfall Profit Tax, First Quarter 1984

By Michael Alexander*

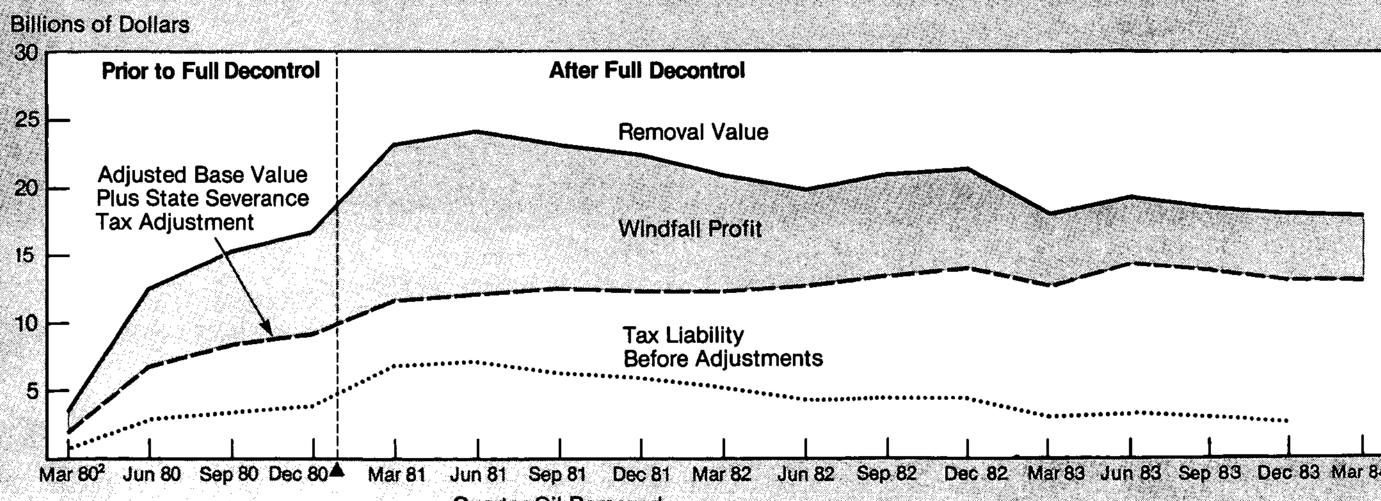
For the first time in 3 years, reported windfall profit tax liability after adjustments increased from the previous quarter. Removal prices for domestic crude oil continued to decline, but increased production pushed the tax liability upward. The windfall profit tax liability for the quarter was $2.4 billion, or 6 percent higher than for the previous quarter (Figure A). Through March 1984, the total amount of windfall profit tax reported since the enactment of the Crude Oil Windfall Profit Tax Act of 1980 was $65.7 billion.

Although the windfall profit, defined as the removal price less the sum of the adjusted base price and state severance tax, decreased by $0.28 per barrel, the windfall profit tax liability increased because of greater production (Figure B). The number of taxable barrels of oil for the quarter increased by 16 million. The daily production increased by 247,000 barrels. The windfall profit per barrel decline resulted from a decline in removal prices in the first quarter of 1984 and an increase in the adjusted base price and state severance tax.

In June 1981, the average removal price reached its highest level, $33.09 per barrel, but has since declined to $25.98 per barrel. The decrease in the removal prices had been a result of both declining demand in the United States for oil products and the worldwide surplus of crude oil. The worldwide glut continued to keep the price of foreign crude oil down in the first quarter of 1984, hence the declining prices of domestic crude oil.

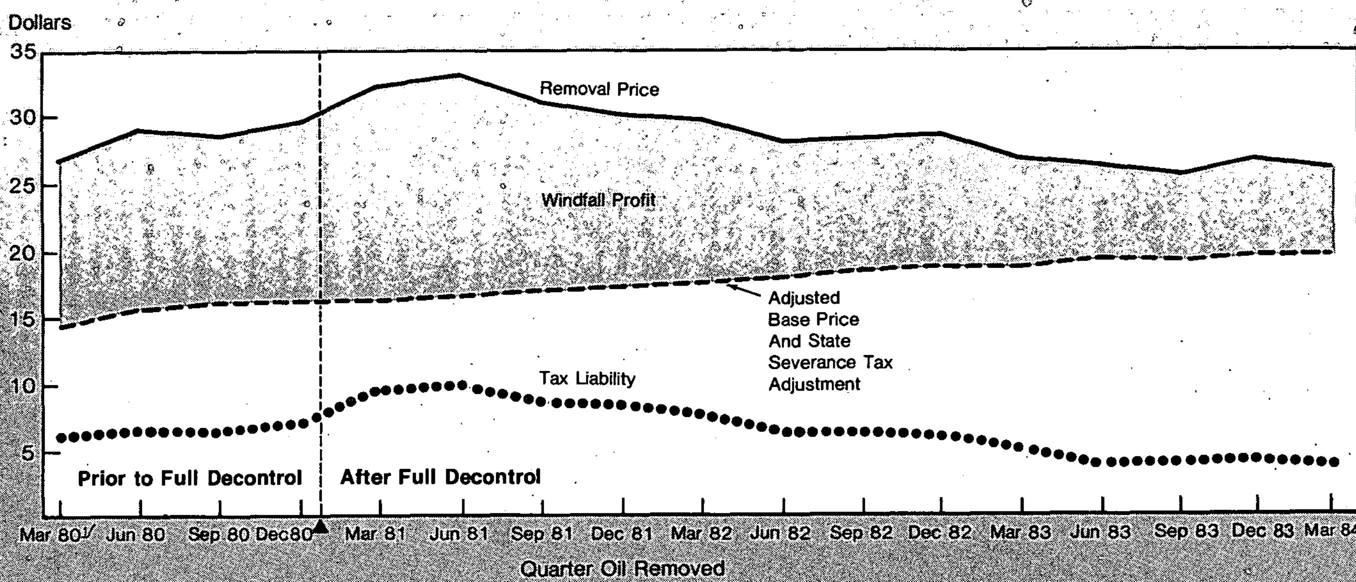
However, the Oil & Gas Journal projects that the 6-year decline in demand for oil products in the United States will end in 1984 [1]. Increased economic growth in the first quarter of 1984 combined with a colder-than-normal winter in 1983/1984 pushed the U.S. demand for oil products upward. The increased demand coupled with a stable supply of domestic crude oil should have, in theory, pushed the price

Figure A
Components[1] of Windfall Profit Tax Liability Before Adjustments: Aggregate Values By Quarter Oil Removed



[1]Some returns report windfall profit tax liability only; therefore, data for removal value, adjusted base value and state severance tax adjustment have been adjusted to reflect totals as if all returns reported this detail.
[2]One month only.

Figure B
Components of Windfall Profit Tax Liability: Averages per Barrel by Quarter Oil Removed



NOTE: Because of price controls during 1980, there were cases where the removal price was less than the adjusted base price and no Form 6047 was filed. The data in the figure are based on information reported.

[1]One month only.

upward. However, the dominant influence of the foreign market has caused the price of domestic crude oil to continue to decline.

The sum of the adjusted base price and the state severance tax adjustment rose 17 percent from $16.69 per barrel for the quarter ending June 1981 to $19.55 for the first quarter of 1984. This increase was primarily a result of an inflation adjustment to the adjusted base price [2].

The following table is a summary, by quarter, of tax liability before and after adjustments since the tax went into effect in 1980. The adjustments were necessary because of errors by withholding agents during previous quarters or, more frequently, reflect the application of the net income limitation. The net income limitation adjustment amounted to -$169 million, and adjustments to previous quarters were approximately -$59 million, for a total adjustment of -$228 million for the quarter ending March 1984.

The net income limitation generates an adjustment because this provision limits the windfall profit to 90 percent of the net income per barrel of oil and can be estimated by certain taxpayers for the current quarter. The adjustments to the previous quarter include under- or over-withholding from previous quarters that the depositing or withholding agent (usually the first purchaser) corrects by adjusting the amounts withheld in succeeding quarters.

Producers can claim as a refund or a credit on their income tax returns additional over-withholding of windfall profit tax, due to error or the net income limitation, that has not been corrected by the withholding agent.

Windfall Profit Tax Before and After Adjustments
(Millions of Dollars)

Quarter Ending	Tax Before Adjustments	Total Adjustments	Tax After Adjustments
Total	$70,318	-$4,633	$65,685
Mar. 1980[1] ...	788	-	788
June 1980	2,842	-21	2,821
Sept. 1980 ...	3,413	-88	3,325
Dec. 1980	3,918	-927	2,991
Mar. 1981	6,953	+242	7,195
June 1981	7,253	-107	7,146
Sept. 1981 ...	6,344	-251	6,093
Dec. 1981	6,007	-497	5,510
Mar. 1982	5,222	-221	5,001
June 1982	4,283	-295	3,988
Sept. 1982 ...	4,404	-445	3,959
Dec. 1982	4,440	-634	3,806
Mar. 1983	3,320	-193	3,127
June 1983	2,951	-203	2,748
Sept. 1983 ...	2,822	-300	2,522
Dec. 1983	2,736	-465	2,271
Mar. 1984	2,622	-228	2,394

[1]One month only.

Based on returns of taxpayers who provided complete detail on windfall profit tax computation [3], tier one oil continued to dominate production for the quarter ended March 1984 (Figure C). Tier one oil (all domestically produced crude oil other than oil specifically classified as tier two or tier three, or oil explicitly exempted from the tax) represented 64 percent of total production. Tier two oil, which represented 8 percent of total production, is oil produced from stripper well property not qualifying for the stripper exemption and oil from economic interests in a Naval Petroleum Reserve held by the United States. Tier three oil, which is heavy oil, incremental tertiary oil and newly discovered oil (61 percent of tier three), accounted for 28 percent of total production. Tier three oil, which is generally taxed at a rate lower than tier one oil, has accounted for a steadily increasing percentage of total production.

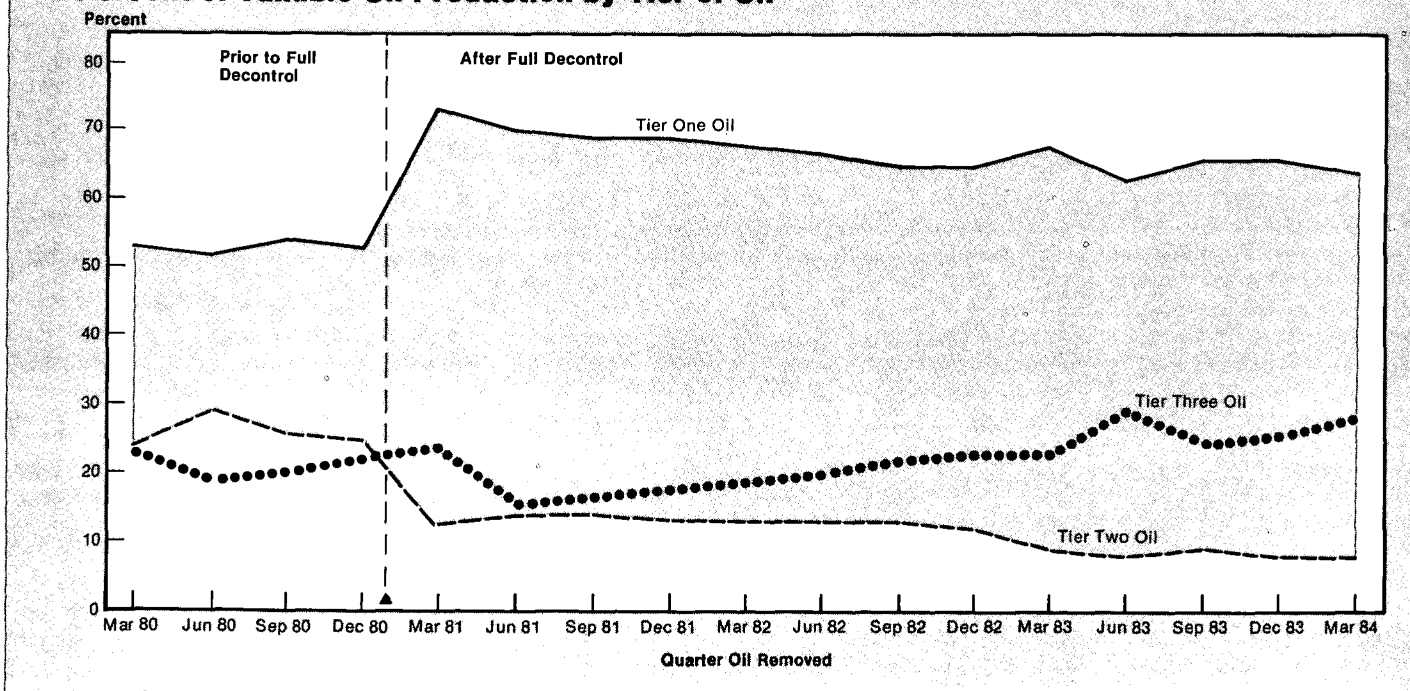
DATA SOURCES AND LIMITATIONS

The windfall profit tax is reported on the Quarterly Federal Excise Tax Return, Form 720. Form 6047, Windfall Profit Tax, shows how the tax is computed and is filed as an attachment to Form 720. Tabulations in this article are based on the Form 6047. Returns are due 2 months after the end of the quarter in which the oil is removed. Data are based on all returns with a tax liability of $1 million or more before adjustments and a 10-percent sample of all other returns.

Sampling and nonsampling errors were controlled by a variety of methods. Although efforts were made to secure missing returns, some returns may have been omitted because of time and resource constraints. Attempts were made to correct imbalances in taxpayer entries for 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. However, to account for returns not reporting the tax computation detail, the components were adjusted using a factor derived from the relationship of the tax liability for those reporting all tax computation detail to the total reported windfall profit tax liability. A number of verification checks were performed at all stages of manual data abstraction and computer tabulation.

The Statistics of Income Bulletin also includes data on excise tax collections. The excise tax collection figures show the liability after adjustments, as reported on Form 720, from returns entered into the Internal Revenue Service computerized Business Master File (BMF) each quarter. A number of considerations affect comparisons of data from these two sources. Returns are not due until 2 months after the close of the taxable quarter; however, the interval between the close of the taxable period and the final recording of the return often varies, so that the quarterly BMF totals usually represent several taxable periods. On the other hand, the data presented here have

Figure C
Percent of Taxable Oil Production by Tier of Oil



been tabulated for specific taxable periods. As a result, the two sets of statistics are not directly comparable.

DEFINITIONS

Brief definitions of the terms used in the tables are given.

Adjusted Base Price.--The base price multiplied by the inflation adjustment, which is derived from the Gross National Product (GNP) "implicit price deflator."

Adjustments to Liability.--Corrections applied to the current quarter's liability to correct for the net income limitation and 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, which would have applied to the oil had it been produced and sold in May 1979, reduced by $0.21. For tiers two and three oil, the base prices were $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.

Deposit Requirements.--The timing of any first purchaser to deposit amounts withheld depends on the identity of the first purchaser. Major refiners, other than independent refiners, are required to make semimonthly deposits of the withholding tax. All other first purchasers are required to make withholding deposits no later than 45 days after the oil is removed from the premises, except independent refiners that purchase oil under delayed payments contracts. They are required to make deposits by the first day of the third month beginning after the month of removal.

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 divides of the Alaska and Aleutian Ranges, and at least 75 miles from the nearest point of the Trans-Alaskan Pipeline System.

Exempt Charitable Oil.--Oil produced from economic interests held by qualified charitable medical facilities, educational institutions, and child care organizations (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, before January 22, 1980, the net proceeds of such oil were dedicated to the support of a medical facility, educational institution, or child care facility.

Exempt Governmental Oil.--Oil produced from an economic interest held by a state or a 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: (a) production received by Indian tribes and individuals from Tribal Trust Lands (the title to 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, the proceeds from which 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 Alaskan Native Corporation prior to 1991, including wholly-owned subsidiaries of the native Indian corporation as clarified by IRS on September 3, 1982.

Exempt Royalty Oil.--Qualified royalty owners are exempt from the windfall profit tax on two barrels of oil per day for each day of the calendar quarter for oil removed after December 31, 1981. For 1985 and thereafter, three barrels per day will be exempt.

Exempt Stripper Oil.--Oil removed from stripper wells after 1982 may qualify for exemption from the windfall profit tax if the following conditions are met:

1 The oil must be removed from a stripper well property after 1982.
2 The oil must be produced by an independent producer.
3 The oil must be attributable to the independent producer's working interest in the property.
4 The stripper well property must not be a property transferred by a nonindependent producer on or after July 23, 1981.

Net Income Limitation.--The windfall profit on a barrel of oil may not exceed 90 percent of the net income attributable to the barrel.

Net Revenue.--This equals the gross revenue from the windfall profit tax, 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.

Removal Price.--Generally, the price for which a barrel of oil is sold. In some instances, a constructive sale 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 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 for 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 tier two or three, or explicitly exempted by law from the tax. This includes the bulk of domestic oil from reservoirs proven to be productive before 1979.

Tier Two Oil.--Any oil 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 Naval Petroleum Reserve. Note that the Crude Oil Windfall Profit Tax Act of 1980 defined tier two oil as from a "National" Petroleum Reserve. This was amended to read "Naval" Petroleum Reserve by the Technical Corrections Act of 1982.

Tier Three Oil, Heavy Oil.--All crude oil (1) produced that had a weighted average gravity of 16.0 degrees or less on the American Petroleum Institute (API) scale, corrected to 60 degrees Fahrenheit, for the last month of production before 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 using 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 sold after May 31, 1979, and 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.

Windfall Profit.--The excess of the removal price of the barrel of oil over the sum of the adjusted base price and the state severance tax adjustment.

NOTES AND REFERENCES

[1] Beck, Robert J., "1984 Midyear Review and Forecast," Oil & Gas Journal, July 30, 1984, p. 133.

[2] The inflation adjustment, calculated by the Internal Revenue Service, Research Division, is published quarterly in the Internal Revenue Bulletin. (See, for example, Internal Revenue Bulletin 1984-11, dated March 12, 1984.)

[3] At the inception of the windfall profit tax (March 1980), taxpayers were not required to complete the detail of the Form 6047, which shows how the tax is computed. However, taxpayers have been required to provide full information as of January 1981.

[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] See also Belal, Carol, and Clark, Phil, "Windfall Profit Tax Liability for 1980," Statistics of Income Bulletin, Fall 1981, pp. 50-54.

[6] See also Alexander, Michael, "Crude Oil Windfall Profit Tax for 1983," Statistics of Income Bulletin, Fall 1984, pp. 59-65.

Table 1.--Windfall Profit Tax Liability by Oil Tier and Tax Rate for Quarter Ending March 1984 Aggregate Components of Windfall Profit

[Money amounts are in millions of dollars]

Oil tier and tax rate	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)
Returns with tax liability shown by oil tier and tax rate, total	643,634	16,726	12,383	209	4,134	2,514
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	269,469	7,625	4,631	119	2,875	1,980
Taxed at 50 percent	25,091	720	435	18	267	142
Tier one, Sadlerochit oil:						
Taxed at 70 percent	116,463	2,035	1,976	11	48	36
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	51,169	1,446	1,039	22	385	214
Taxed at 30 percent	2,292	67	48	1	18	6
Tier three oil (taxed at 30 percent):						
Newly discovered oil[1]	108,925	3,204	2,763	30	411	93
Incremental tertiary oil	39,241	993	865	7	121	38
Heavy oil	30,984	636	625	([2])	11	5
Returns with total tax liability only	-	-	-	-	-	108

[1]Newly discovered oil is taxed at 22.5 percent beginning in 1984.
[2]Less than $500,000.
NOTE: Detail may not add to total because of rounding.

Table 2.--Windfall Profit Tax Liability for Returns Reporting Components of Windfall Profit by Oil Tier and Tax Rate for the Quarter Ending March 1984 Average Daily Production and Average Dollars per Barrel

Oil tier and tax rate	Daily production (000's) (barrels)	Removal price	Adjusted base price	State severance tax adjustment	Windfall profit	Tax liability before adjustments
	(1)	(2)	(3)	(4)	(5)	(6)
All returns, total	7,072	25.98	19.23	.32	6.43	3.90
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	2,961	28.29	17.18	.44	10.67	7.34
Taxed at 50 percent	276	28.68	17.35	.71	10.62	5.65
Tier one, Sadlerochit oil:						
Taxed at 70 percent	1,280	17.47	16.97	.09	.41	.30
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	562	28.26	20.29	.43	7.54	4.17
Taxed at 30 percent	25	29.16	20.83	.44	7.89	2.63
Tier three oil (taxed at 30 percent):						
Newly discovered oil[1]	1,197	29.41	25.36	.27	3.78	.85
Incremental tertiary oil	431	25.31	22.05	.17	3.09	.97
Heavy oil	340	20.52	20.17	-	.35	.14

[1]Newly discovered oil is taxed at 22.5 percent beginning in 1984.
NOTE: Detail may not add to total because of rounding.

Table 3.--Exempt Oil Volume by Tier and Category, Quarter Ending March 1984

[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	78,143	17,546	45,466	13,730	959	442
Exempt governmental interest	16,514	13,261	726	1,752	509	267
Exempt charitable interest	1,029	477	327	168	50	6
Exempt Indian oil	1,574	425	847	259	34	8
Exempt Alaskan oil	8,703	50	-	8,653	-	-
Exempt Royalty oil	10,192	3,332	3,435	2,899	366	159
Exempt Stripper oil	40,131	-	40,131	-	-	-

NOTE: Detail may not add to total because of rounding.