

Crude Oil Windfall Profit Tax, 1985

By Edward Chung*

Crude oil windfall profit tax (after adjustments) for the fourth quarter of 1985 was \$1.0 billion. This was the lowest amount of windfall profit tax reported since the first full quarter (June 1980) for which the tax was reported. The total reported windfall profit tax after adjustments since the enactment of the Crude Oil Windfall Profit Tax Act of 1980 amounted to almost \$78 billion through December 1985.

The Crude Oil Windfall Profit Tax Act imposed a Federal excise tax on domestic crude oil extracted on or after March 1, 1980. The tax was enacted in response to the planned phaseout of Government price controls on domestic crude oil. The Act was intended to tax a fair share of the additional revenues received by oil producers and royalty owners as a result of oil price decontrol, yet not adversely affect domestic production. Congress designated the windfall profit tax to be temporary, with a 33-month gradual phaseout. This phaseout will begin in January 1988, if

\$227.3 billion in net revenue (see the Definitions) will have been realized by then; otherwise, no later than January 1991 [1].

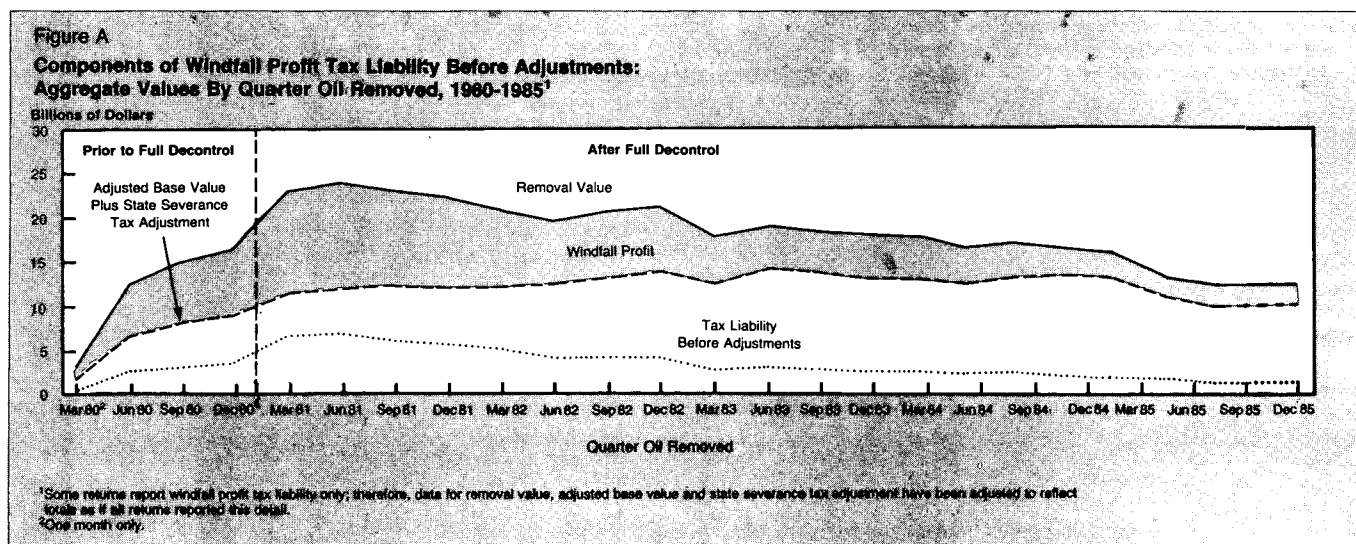
The formula to calculate the "windfall profit" (WP) is:

$$WP = RP - (ABP + SST)$$

where:

RP = Removal Price
ABP = Adjusted Base Price
SST = State Severance Tax Adjustment

The windfall profit declined from a high of \$11.9 billion for the quarter ending June 1981 to \$1.6 billion for the quarter ending December 1985 (Figure A) [2]. This decrease was a result of declines in the "removal price" (generally the price for which oil is sold) and rises in the "adjusted base price" and State severance tax adjustment (see the Definitions at the end of this article).



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Since June 1981, when the average removal price for domestic crude oil was at its height, the removal price had fallen by almost 23 percent, from \$33.09 to \$25.43 per barrel for the quarter ending December 1985 (Figure B).

The total windfall tax liability reported (after adjustments) for Calendar Years 1980-1985 totalled \$77.8 billion. Of the total tax, 1981 accounted for the largest proportion (33 percent) and 1985 the lowest (7 percent)--a decline from 1981 to 1985 of 78 percent (Figure C). Some returns report windfall profit tax only; therefore, data for removal value, adjusted base value, State severance tax, and the resulting windfall profit have been adjusted to account for the missing detail. Concomitant with this decline in tax liabilities was a decrease in reported windfall profit of 78 percent from 1981 to 1985.

The immediate cause for falling profits was the combined effect of declining removal price (down by 36 percent from 1981) accompanied by a 1 percent growth in the sum of the adjusted base value and State severance tax (Figure D). The adjusted base price increased chiefly as a result of a required inflation adjustment derived from the Gross National Product (GNP) implicit price deflator [3].

Figure C
Windfall Profit Tax Liability After Adjustments by Year, 1980-1985

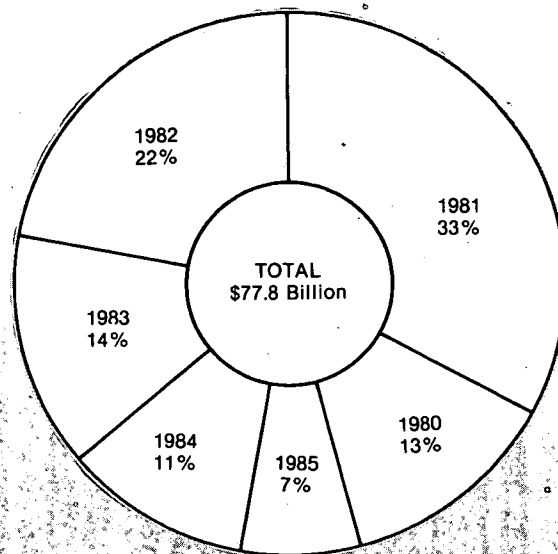
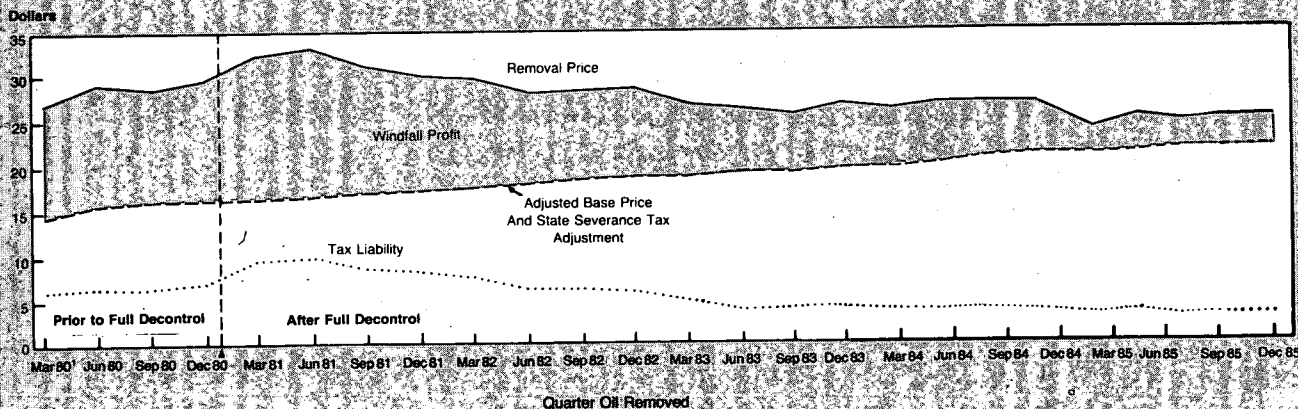


Figure B
**Components of Windfall Profit Tax Liability:
Averages per Barrel by Quarter Oil Removed, 1980-1985**

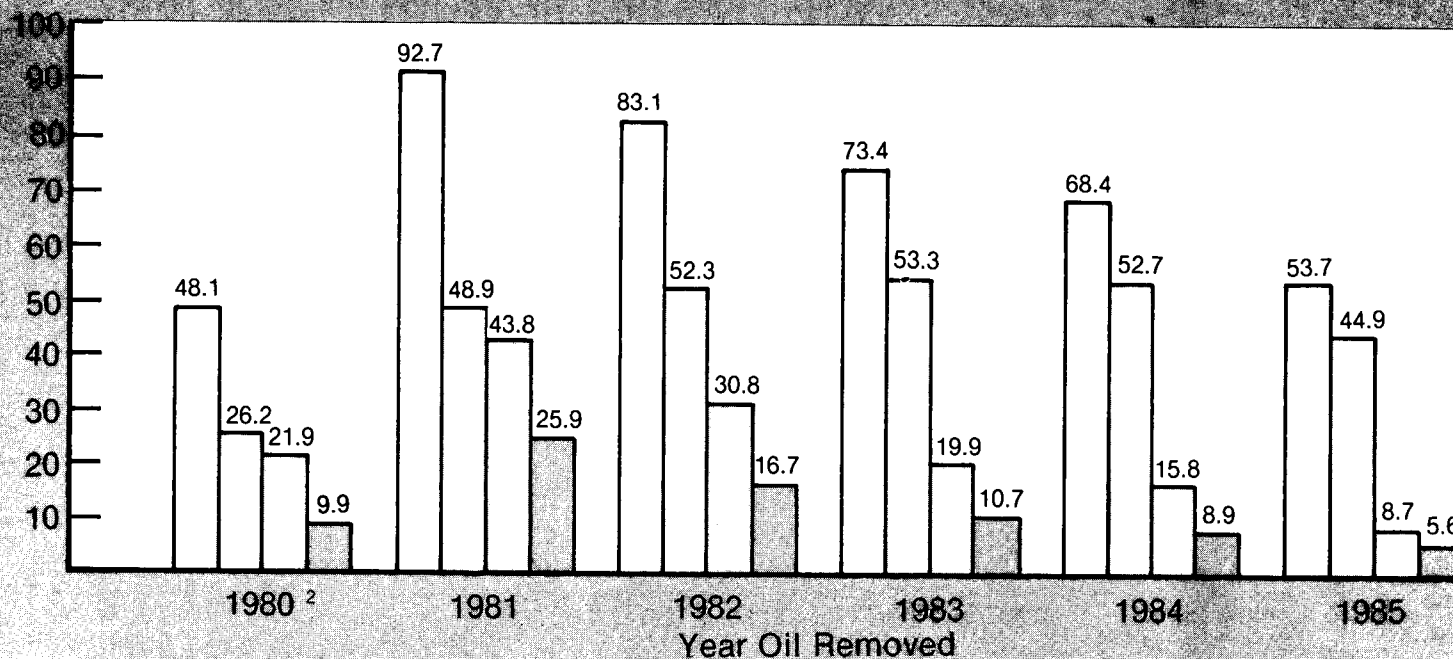


NOTE: Because of price controls during 1980, there were cases where the removal price was less than the adjusted base price and no Form 6047 was filed. The data in the figure are based on information reported.

*One month only.

Figure D
Components of Windfall Profit Tax Liability After Adjustments, 1980-1985¹

Billions of Dollars



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 Represents only 10 months.



Figure E is a summary, by quarter, of tax liability before and after adjustments since the tax went into effect in 1980, as shown on windfall profit tax returns. The adjustments were necessary because of errors by withholding agents during previous quarters or, more frequently, because of application of the net income limitation.

Figure E--Windfall Profit Tax Before and After Adjustments
(Millions of dollars)

Quarter Ending	Tax Before Adjustments	Total Adjustments	Tax After Adjustments
Total	\$83,668	-\$5,911	\$77,757
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
June 1984 ...	2,468	-218	2,250
Sept. 1984 ...	2,447	-200	2,247
Dec. 1984 ...	2,236	-256	1,980
Mar. 1985 ...	1,850	-117	1,733
June 1985 ...	1,653	-132	1,521
Sept. 1985 ...	1,442	-146	1,296
Dec. 1985 ...	1,254	-209	1,045

¹One month only.

The net income limitation generated an adjustment because it limits the windfall profit to 90 percent of the net income per barrel of oil and was estimated by certain taxpayers for the current quarter ending December 1985. The adjustments to the previous quarter were for under- or over-withholding from previous quarters that the depositing or withholding agent (usually the first purchaser) corrected by adjusting the amounts withheld in succeeding quarters. Producers claimed 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 was not corrected by the withholding agent. The amount of the two types of tax adjustments for the fourth quarter of 1985 is shown below:

Adjustments to tax, fourth quarter 1985
(Millions)

Net income limitation	-\$190
Prior quarters	-19
Total Adjustments	-\$209

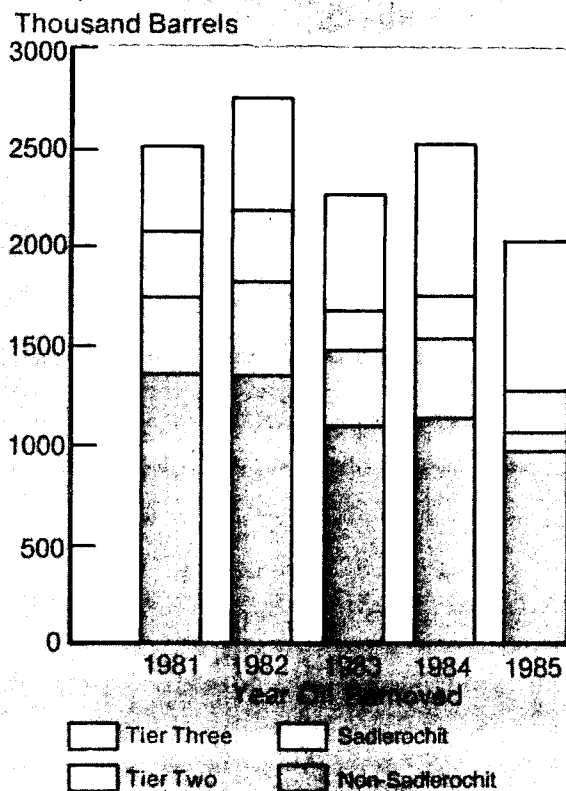
Based on returns of taxpayers that provided complete detail on the windfall profit tax computation [4], "tier one oil" continued to dominate production for the quarter ending December 1985. Tier one oil (all domestically produced crude oil other than oil specifically classified as tier two or tier three, or oil explicitly exempted from the tax) represented 46 percent of total production. "Tier two oil," which represented 11 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 (the latter represented 53 percent of tier three oil), accounted for 43 percent of total production (Figure F). Since the inception of the tax, 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 Forms 6047 reporting a tax liability. Therefore, total domestic taxable production will be somewhat understated. 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 error was controlled by a variety of methods. Although efforts were made to secure missing returns, some returns may have been omitted because of time and other statistical processing 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 tax liability for each tier was tabulated from it. However, for returns that did not report the tax computation detail (for Figures A and D only), the components were estimated using a factor derived from the relationship of the tax liability for those reporting all of the tax computation detail to the total reported tax liability. A number of

Figure F
Components of Oil Reported for
Windfall Profit Tax Purposes by
Year, 1981-1985



verification checks were performed at all stages of manual data abstraction and computer compilation.

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 (IRS) 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 may represent more than one taxable period. 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.

DEFINITIONS

The following are brief definitions of the terms used in the tables.

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

Adjustments to Tax Liability.--Corrections applied to the current quarter's tax 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 applied only to natural crude petroleum and did not include synthetic petroleum, such as oil from shale or tar sands. It did, 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 depended on the identity of the first purchaser. Major refiners, other than independent refiners, were required to make semi-monthly deposits of the withholding tax. All other first purchasers were required to make withholding deposits no later than 45 days after the oil was removed from the premises, except independent refiners that purchased oil under delayed payments contracts. The latter were 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 had 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 interests were 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

from 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 was 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 was one of the following: (a) production received by Indian tribes and individuals from Tribal Trust Lands (the title to such land was 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 were paid into the U.S. Treasury to the credit of tribal or native trust funds pursuant to law. This exemption also applied to production by any Alaskan Native Corporation prior to 1991, including wholly-owned subsidiaries of such corporations.

Exempt Royalty Oil.--Qualified royalty owners were 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 were to be exempt.

Exempt Stripper Oil.--Oil removed from stripper wells could qualify for exemption from the windfall profit tax if the following conditions were met:

- (1) The oil had to be removed from a stripper well property after 1982;
- (2) The oil had to be extracted by an independent producer;
- (3) The oil had to be attributable to the independent producer's working interest in the property; and
- (4) The stripper well property could 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 could not exceed 90 percent of the net income attributable to the barrel.

Net Revenue.--This equaled 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 income tax deductions for windfall profit tax paid. Figures presented in this report are the gross tax liabilities reported by the withholding agents on Form 6047 and are before the reductions mentioned above.

Removal Price.--Generally, the price for which a barrel of oil was sold. In some instances, a constructive sales price was 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 was reduced by the amount by which the severance tax exceeded 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 was 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 included 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 from property 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) had been undertaken. The non-incremental oil (i.e., the amount of production up to the base level) remained 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] Staff of the Joint Committee on Taxation, General Explanation of the Crude Oil Windfall Profit Tax Act of 1980, U.S. Government Printing Office, 1981.

[2] Since the windfall profit tax has fallen to such a low level, statistics will no longer be published each quarter. However, the tables will be published annually in the

Fall issue of the Statistics of Income Bulletin.

The table showing annual fiscal year receipts was not produced due to the data not being available at time of publication.

[3] The inflation adjustment, calculated by the Internal Revenue Service, Research Division, is published quarterly in the Internal Revenue Bulletin. (See Internal Revenue Bulletin 1985-37, September 16, 1985.)

[4] At the inception of the windfall profit tax (March 1980), taxpayers were not required to complete the detail called for on the Form 6047, which shows how the tax was computed. However, taxpayers were required to provide full information as of January 1981.

Crude Oil Windfall Profit Tax, 1985

Table 1.--Windfall Profit Tax Liability by Oil Tier, Tax Rate and Aggregate Components of Windfall Profit, Quarter Ending December 1985

[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	466,675	11,874	10,160	81	1,634	1,248
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	197,913	5,133	3,631	61	1,440	1,050
Taxed at 50 percent	17,535	477	329	8	140	67
Tier one, Sadlerochit oil:				(1)	(1)	(1)
Taxed at 70 percent	1,333	24	24	-	-	-
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	47,945	1,261	1,040	8	212	121
Taxed at 30 percent	2,092	44	37	(1)	7	3
Tier three oil (taxed at 30 percent):						
Newly discovered oil ¹	105,634	2,684	2,820	2	-139	4
Incremental tertiary oil	55,275	1,452	1,436	(1)	16	2
Heavy oil	38,948	799	842	(1)	-43	1
Returns with total tax liability only	-	-	-	-	-	6

¹Amount is less than \$500,000.²Newly discovered oil is taxed at 22.5 percent from 1984 to 1987.

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

Table 2.--Average Windfall Profit Tax Liability for Returns Reporting Components of Windfall Profit by Oil Tier and Tax Rate, Quarter Ending December 1985

Oil tier and tax rate	Average daily production (000's) (barrels)	Average per barrel (in dollars)				
		Removal price	Adjusted base price	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	5,073	25.44	21.77	.17	3.50	2.67
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	2,151	25.93	18.34	.30	7.29	5.30
Taxed at 50 percent	191	27.20	18.76	.43	8.01	3.84
Tier one, Sadlerochit oil:						
Taxed at 70 percent	14	18.24	18.08	.01	.15	.12
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	521	26.30	21.70	.17	4.43	2.51
Taxed at 30 percent	23	21.13	17.78	.17	3.18	1.64
Tier three oil (taxed at 30 percent):						
Newly discovered oil ¹	1,148	25.40	26.69	.02	-1.31	.03
Incremental tertiary oil	601	26.27	25.97	(²)	-.30	.03
Heavy oil	423	20.51	21.61	(²)	-1.10	.01

¹Newly discovered oil is taxed at 22.5 percent from 1984 to 1987.²Amount under \$.005.

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

Table 3.--Exempt Oil Volume by Tier and Category, Quarter Ending December 1985

[Thousands of barrels]

Exempt oil	Total	Tier one	Tier two	Tier three		
				Newly discovered oil	Incremental tertiary oil	Heavy oil
	(1)	(2)	(3)	(4)	(5)	(6)
Total	75,116	10,809	45,002	17,107	1,582	615
Exempt governmental interest	11,461	7,251	730	2,059	947	473
Exempt charitable interest	796	312	302	89	80	13
Exempt Indian oil	931	316	158	304	144	9
Exempt Alaskan oil	11,473	114	-	11,359	-	-
Exempt royalty oil	10,114	2,817	3,470	3,296	411	120
Exempt stripper oil	40,342	-	40,342	-	-	-

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

Table 4.--Windfall Profit Tax Liability by Oil Tier, Tax Rate and Aggregate Components of Windfall Profit, January through December 1985

[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	2,035,908	51,080	42,399	381	8,300	5,901
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	907,689	23,800	16,279	282	7,239	4,984
Taxed at 50 percent	78,467	2,068	1,430	38	601	301
Tier one, Sadlerochit oil:						
Taxed at 70 percent	94,651	1,659	1,657	5	-4	18
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	197,701	5,098	4,151	36	911	517
Taxed at 30 percent	9,964	160	136	1	23	20
Tier three oil (taxed at 30 percent):						
Newly discovered oil ¹	428,153	10,682	11,143	14	-474	27
Incremental tertiary oil	192,280	4,948	4,864	5	79	27
Heavy oil	127,004	2,664	2,739	(²)	-75	6
Returns with total tax liability only	-	-	-	-	-	299

¹Newly discovered oil is taxed at 22.5 percent from 1984 to 1987.²Amount is less than \$500,000.

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

Crude Oil Windfall Profit Tax, 1985

Table 5.--Average Windfall Profit Tax Liability for Returns Reporting Components of Windfall Profit by Oil Tier and Tax Rate, January through December 1985

Oil tier and tax rate	Average daily production (000's) (barrels)	Average per barrel (in dollars)				
		Removal price	Adjusted base price	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	5,578	24.98	20.54	.19	4.25	2.97
Tier one, other than Sadlerochit oil:						
Taxed at 70 percent	2,487	26.30	17.82	.31	8.17	5.54
Taxed at 50 percent	215	26.11	18.06	.49	7.56	3.83
Tier one, Sadlerochit oil:						
Taxed at 70 percent	259	17.51	17.50	.06	-.04	.19
Taxed at 50 percent	-	-	-	-	-	-
Tier two oil:						
Taxed at 60 percent	542	25.62	20.77	.19	4.67	2.64
Taxed at 30 percent	27	14.76	12.60	.13	2.03	2.15
Tier three oil (taxed at 30 percent):						
Newly discovered oil ¹	1,173	24.80	25.81	.03	-1.04	.07
Incremental tertiary oil	527	25.52	25.02	.03	.46	.18
Heavy oil	348	21.18	21.54	(²)	-.36	.06

¹Newly discovered oil is taxed at 22.5 percent from 1984 to 1987.²Amount is less than \$0.005.

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

Table 6.--Exempt Oil Volume by Tier and Category, January through December 1985

[Thousands of barrels]

Exempt oil	Total	Tier one	Tier two	Tier three		
				Newly discovered oil	Incremental tertiary oil	Heavy oil
	(1)	(2)	(3)	(4)	(5)	(6)
Total	292,944	60,844	165,123	59,235	5,395	2,347
Exempt governmental interest	61,647	45,618	3,076	7,978	3,130	1,845
Exempt charitable interest	3,399	1,515	1,125	366	357	36
Exempt Indian oil	4,055	1,590	686	1,413	348	19
Exempt Alaskan oil	36,080	457	-	35,623	-	-
Exempt royalty oil	40,666	11,664	13,139	13,856	1,560	447
Exempt stripper oil	147,097	-	147,097	-	-	-

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