

Windfall Profit Tax Liability for 1980

By Carol Belal and Phil Clark*

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. This Act affects almost every taxpayer with an economic interest in an oil well. The tax is imposed at different rates on various categories, or tiers, of oil, with exemptions provided for certain taxpayers or types of production. The tax is temporary and will phase out over a 33-month period beginning in January 1988, if \$227.3 billion in "net revenue" (see Definitions) has been realized, but not later than January 1991.

Preliminary statistics for 1980 show an accrued tax liability of nearly \$10 billion after adjustments, as reported on 1980 returns filed through mid-1981. In general, adjustments reflect corrections applied to the current quarter's liability in order to correct over- and under-withholding in previous quarters. A more detailed discussion of adjustments appears later in this article. Liability before and after adjustments for each quarter is shown below.

Millions of dollars

Quarter ending	Tax before adjustments	Adjustments	Tax after adjustments
Total.....	10,961	-1,036	9,925
March 1980.....	788	-	788
June 1980.....	2,842	-21	2,821
September 1980..	3,413	-88	3,325
December 1980...	3,918	-927	2,991

THE TAX

The computation of windfall profit is as follows:

EQUALS	Windfall Profit
LESS	Removal Price
	Sum of Adjusted Base Price and State Severance Tax Adjustment

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 an inflation adjustment factor [1], which is computed by the Internal Revenue Service (IRS) for each calendar quarter. 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 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.

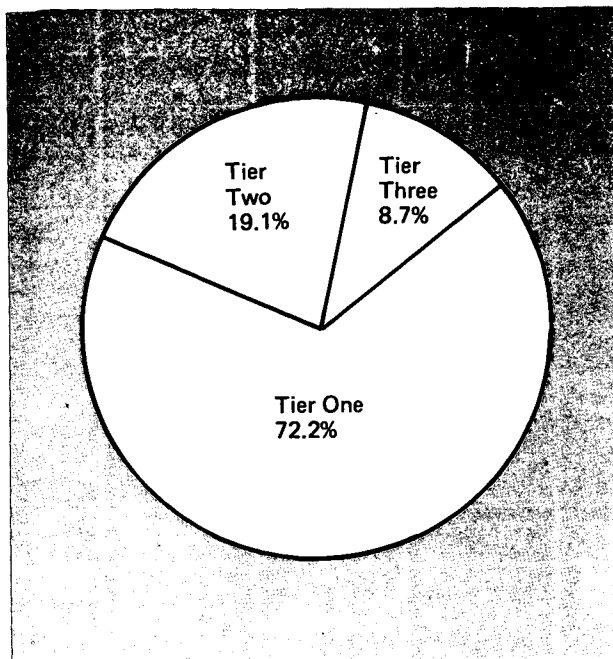
The Economic Recovery Tax Act of 1981 provided for two changes in the tax rates. Independent producers' stripper well production after December 31, 1982, will be exempt from tax. In addition, the tax rate on newly discovered oil will be phased down from 30 percent in 1981 to 15 percent in 1986.

The reasons behind the differential rate structure, as described by the Staff of the Joint Committee on Taxation [2], are as follows:

Congress believed that the large price increases resulting from phased decontrol and extraordinary increases in world oil prices were an appropriate object of taxation. However, it believed that any such tax should be structured carefully to eliminate, as much as possible, adverse effects on domestic production. For this reason, the Act contains lower tax rates for those types of oil whose production Congress believed to be especially responsive to more lenient tax treatment, such as newly discovered oil, tertiary oil, stripper oil and heavy oil. Because of the significant contribution made by independent producers, the Act contains reduced tax rates for up to 1,000 barrels per day of tier one and tier two production by independent producers.

In 1980, the tax liability generated by the production of tier one oil resulted in the majority of the total liability. The distribution of fourth quarter 1980 tax liability before adjustments among oil tiers for those filers who reported such detail looked as follows.

*Windfall Profit Tax Statistics Group. Prepared under the direction of William J. Smith, Jr.



The tax is imposed upon 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, the first purchaser, or other 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. An increase in the number of withholding agents is anticipated for 1981, due to revisions in the IRS regulations which allow qualified disbursers (see Definitions) to elect to withhold the tax.

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. The large adjustment shown for the fourth quarter of 1980 reflects corrections for overpayments made due to uncertainty among taxpayers regarding the timing for accounting for the effects of the net income limitation provision of the Act. This provision limits the windfall profit to 90 percent of the net income per barrel of oil. Clarifying regulations issued by IRS in October 1980 allowed taxpayers not subject to withholding to take the net income limitation into account currently, on a quarter-by-quarter basis. Many taxpayers had interpreted the instructions for tax payments to mean that the limitation could only be used after the close of

the taxable year. Thus, adjustments for the fourth quarter of 1980 were especially large, taking into account overpayments since the enactment of the tax.

Not reflected in the data in this article are adjustments to 1980 windfall profit tax liability made after the close of the year. Over-withholding of windfall profit tax (including overpayment due to the net income limitation) which was not corrected by the withholding agent could be claimed as a refund or credit by the producer. An under-withholding amount which was not corrected was deposited by the producer. Any windfall profit tax paid which was not recovered in one of the above-mentioned manners could be treated as a deduction against the income from the oil property in question, resulting in a reduction in income tax liability. In addition, the Omnibus Reconciliation Act of 1980 allowed a credit or refund of up to \$1,000 for individuals, family farm corporations, and estates with royalty interests. The Economic Recovery Tax Act of 1981 increased the credit to \$2,500 for 1981. After 1981, the royalty owner's credit will be replaced with an exemption of up to 2 barrels per day of qualified royalty owners' production in 1982, 1983, and 1984; this exempt amount will increase to three barrels in 1985 and thereafter.

BASIC TABLE INFORMATION

Shown in Table 1 is tax liability by tier and tax rate for the quarter ending December 1980, and for Calendar Year 1980. The tax was tabulated from over 2,000 returns for the year, between 500 and 600 per quarter. Also shown in the table are the components of the windfall profit. Although taxpayers were not required to show the components until January 1981, they did so on 64 percent of the returns. Significantly, these returns accounted for only 18 percent of the tax liability. The first two columns of Table 1 represent data from all returns filed. The last six columns represent data only for those returns which had the components of the windfall profit shown.

Tabulations in the Bulletin represent returns filed for 1980 which were received through mid-1981. Returns filed for 1981 as well as amended returns may result in further adjustments to 1980 tax liability. On that basis, revised data may appear in future issues of the Bulletin.

DATA SOURCES AND LIMITATIONS

The Quarterly Federal Excise Tax Return, Form 720, is the form on which the windfall profit tax is reported. 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.

As returns are received in the ten IRS Service Centers, photocopies of the Form 720, Form 6047, and all related attachments are sent to the IRS Statistics Division in Washington, DC, for statistical processing.

Windfall Profit Tax Quarterly Returns, 1980

Table 1.--Windfall Profit Tax Liability by Oil Tier and Tax Rate for the Quarter and Year Ended December 31, 1980; Components of Windfall Profit for the Year Ended December 31, 1980

[Money amounts are in millions of dollars]

Oil tier and tax rate	Tax liability before adjustments		Returns with components of windfall profit year ended Dec. 31, 1980 ¹					
	Quarter ended Dec. 31, 1980	Year ended Dec. 31, 1980	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.....	3,918	10,961	299,603	8,731	4,580	170	3,981	1,994
Returns with tax liability shown by oil tier and tax rate:								
Total.....	3,565	8,857	299,603	8,731	4,580	170	3,981	1,994
Tier one, other than Sadlerochit oil:								
Taxed at 70 percent.....	2,139	4,815	128,891	3,081	1,758	46	1,277	894
Taxed at 50 percent.....	135	314	27,598	633	387	13	233	116
Tier one, Sadlerochit oil:								
Taxed at 70 percent.....	298	646	2,597	70	34	2	34	24
Taxed at 50 percent.....	2	11	386	15	5	(2)	10	4
Tier two oil:								
Taxed at 60 percent.....	541	1,715	41,173	1,473	682	33	758	454
Taxed at 30 percent.....	141	485	37,085	1,377	630	29	718	215
Tier three oil (taxed at 30 percent):								
Newly discovered oil.....	222	617	48,249	1,759	890	44	825	248
Incremental tertiary oil.....	4	9	552	15	9	(2)	6	2
Heavy oil.....	83	245	13,072	309	186	1	122	37
Total returns with tax liability not shown by oil tier and tax rates.....	353	2,105	-	-	-	-	-	-

¹Represents 64 percent of all returns filed. Filers were not required to report this detail for 1980.²Less than \$500,000.

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

The Internal Revenue Service also releases windfall profit tax statistics in a quarterly report on all excise taxes [3]. These 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 input of the return often varies, so that the quarterly BMF totals can represent several taxable periods. On the other hand, the SOI data are for specific taxable periods, and the returns on which they are based are selected prior to BMF processing. As a result, the two tabulations 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. Although attempts were made to secure all returns filed, some small 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.

Definitions

Brief definitions of many of the terms used in this article are given below. For a more detailed treatment see Reference [2], below.

Adjusted Base Price.--The base price multiplied by the inflation adjustment, which is determined from the "implicit price deflator" used by the Department of Commerce in estimating the gross national product [1].

Base Price.--For tier one oil, the upper tier ceiling price, as defined by Department of Energy price control regulations [4], 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.

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 non-working 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 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 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 [5] 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 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] Joint Committee on Taxation (staff), General Explanation of the Crude Oil Windfall Profit Tax Act of 1980. U.S. Government Printing Office, 1981.
- [3] "Internal Revenue Collections of Excise Taxes," released quarterly by the Internal Revenue Service.
- [4] The pricing regulations were most recently published in 46 Federal Register 20512, April 3, 1981.
- [5] 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.