The original documents are located in Box 27, folder "Windfall Profits Tax" of the Loen and Leppert Files at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE
WASHINGTON

Date 3/20/75

TO: ~~CHARLIE LEPPERT~~

FROM: Douglas P. Bennett

For Your Information

Please Handle

Per Our Conversation

Other: I thought you might be interested in seeing this document prepared by the Treasury Dept. which describes the Windfall Profits Tax proposal.

Doug

WINDFALL PROFITS TAX

General Explanation.

1. Summary of Proposal.

A Windfall Profits Tax at rates graduated from 15 percent to 90 percent will be imposed on that portion of the price per barrel that exceeds the producer's adjusted base price and therefore represents a windfall profit. The windfall profit subject to tax may not, in any event, exceed 75 percent of the net income attributable to the barrel of oil. The initial "adjusted base price" will be the producer's ceiling price per barrel on December 1, 1973, plus 95 cents to adjust for subsequent increased costs and higher price levels generally. Each month the base will be adjusted upward on a specified schedule, which will gradually raise the adjusted base price to reflect long-run supply conditions and provide the incentive for investment in petroleum exploration and development as well as secondary and tertiary recovering methods. Percentage depletion will not be allowed on the gross income attributable to the portion of the price represented by the windfall profits tax liability. The tax will be retroactive to January 1, 1975.

2. Purpose and Effect of Proposal.

During 1974, world petroleum prices increased dramatically due to the actions of the OPEC cartel in raising prices and cutting back production. These conditions have driven up the market price of uncontrolled domestic crude. As a result, domestic producers, whose exploration and operating costs have generally not increased as much as oil prices, have realized windfall profits. Decontrol of oil prices will increase these prices and, for many producers, further windfall profits may result.

The purpose of the Windfall Profits Tax is to ensure that the rise in international oil prices and the end of controls on domestic prices does not result in one sector of the economy benefiting unfairly at the expense of other sectors. This tax does not itself cause price increases, but simply recaptures the profits from price increases otherwise induced. The estimated gross liability of all producers for the Windfall Profits Tax for calendar year 1975 is $14 billion. Thus, in aggregate, the Windfall Profits Tax for 1975 is sufficient to absorb an amount equal to the increased gross income of $11 billion that would otherwise flow from decontrolling oil prices, plus an additional $3 billion.

3. Background.

On December 19, 1973, the Administration proposed a similar tax. On November 21, 1974, the Committee on Ways and Means ordered reported H. R. 17488 (the Energy Tax and Individual Relief Act of 1974) which included a similar tax. Four essential differences between H. R. 17488 and this proposal are:

(1) H. R. 17488 included a "plowback" provision which forgave the tax if the windfall profits were reinvested in certain energy producing activities. This necessitated a recomputation of the tax on a cumulative basis. This proposal does not have a plowback provision. The only recomputation aspect of this proposal is that which is necessitated by a 75 percent net income limitation which is invoked by the taxpayer after the purchaser collects the tax.

(2) This proposal increases the range of rates from 15% to 90%. Rates ranged from 10% to 85% under H. R. 17488.

(3) This proposal has a higher initial tax-free level, but a considerably slower phase-out of the tax than under H. R. 17488.

(4) This proposal provides for monthly payment of the tax as compared to the annual tax under H. R. 17488.

Technical Explanation.

1. Imposition of Excise Tax.

Under the proposal, an excise tax is imposed on the windfall profit portion of the price of each barrel of crude oil. Since the tax is measured in part by the price per barrel of oil, it is imposed as an excise tax, even though it has features similar to our income tax (such as graduated rates) and it is never imposed on an amount in excess of 75% of the net income attributable to such barrel.

The tax is imposed only on crude oil produced from an oil or gas well located in the United States or in a possession of the United States, including oil derived from exploitation of the continental shelf (as defined in section 638). The term "crude oil" for this purpose includes all liquid hydrocarbons which are sold or transported as oil at the cutoff point for depletion purposes, that is, sold in the immediate vicinity of the well (See Treas. Reg. §1.613-3(a)). Thus, the term includes so-called natural gas liquids produced from a gas well which are separated from natural gas before the cutoff point in lease separators or similar field facilities (that is, lease condensates). However, the term does not include gasoline or other liquefied petroleum gases produced in gasoline plants or gas processing plants (since this process for depletion purposes is considered as manufacturing). Finally, the tax is imposed on a standard "barrel" which means 42 United States gallons.

Under the proposal, the person who takes the depletion deduction with respect to the oil is liable for the tax. In the case of a partnership, or of a trust or estate, tentative tax liability on oil in which the partnership, estate or trust owns an interest must be allocated among the partners, or among the trust or estate and its beneficiaries, as the case may be. In the case of partnerships, this allocation will be made in the same manner as the income subject to depletion is allocated under the existing law. Similar allocation rules will be provided by regulations for trusts and estates.

2. Computation of Windfall Profits Tax Liability.

Under the proposal, the amount of Windfall Profits Tax liability is to be computed according to a graduated rate schedule on the windfall profit portion of the price received, actually or constructively (the "removal price"), for each barrel of oil. The windfall profit is the excess of the removal price over the base price, adjusted as explained below. The base price will differ depending upon the type, grade, and location of the oil involved.

The amount subject to tax will not exceed 75% of the net income attributable to the barrel of oil. Net income attributable to the barrel will be the same as taxable income from the property for purposes of the 50% limitation under section 613(a) divided by the number of barrels produced from the property, with certain modifications. Net income will be computed without regard to the percentage depletion allowance (but cost depletion will be allowable), the deduction for the Windfall Profits Tax, and any intangible drilling costs deductible under section 263(c). Expenditures otherwise deductible under section 263(c) are not deductible except through cost depletion because they are expenditures which are capital in nature.

Since the Windfall Profits Tax is imposed at graduated rates, and since the prices for oil vary depending on type, grade, and location, a taxpayer's liability must be computed on a barrel-by-barrel basis.

The "removal" price is generally the actual sales price for each barrel of oil sold. There is seldom a case where the producer, the pipeline or gathering company, and the refiner are not separate entities between which there will be at least a paper transaction. However, it is not uncommon for the producer and the purchaser to be related. In cases of sales between related persons, or where the oil is transported from the premises by an integrated producer-refiner before sale or refining begins, the "removal" price is a constructive sales price determined in the same manner as is the "representative market or field price" under Treasury Regulations §1.613-3. Under these regulations, the constructive sales price is determined on the basis of actual prices received in a competitive market for similar quantities and types of oil in the same locations. For this purpose, the term "related persons" has the same meaning as it does under section 103(c)(6) for purposes of the small issue exemption from the limitation on the issuance of tax-exempt industrial revenue bonds.

The base price will be established under the rules contained in the regulations of the Cost of Living Council prescribing the method for setting the ceiling price on domestically produced oil, as those regulations were in effect on December 1, 1973 (CLC Reg. §150.353). Under those regulations, the ceiling price was the posted field price on May 15, 1973, for the particular type and grade of oil in the particular location, plus 35¢ per barrel. The ceiling price varied as the type and grade or oil varied. With respect to "new" oil which is exempt from price controls and does not have a ceiling price, a base price will be constructed by comparison of prices of similar types, grades, and locality.

The base price so determined will be adjusted upward each month. The base price adjustment for each month will be set out in the following table covering the number of months for which the tax is effective.

August 7, 1975

MEMORANDUM FOR: JACK MARSH

FROM: CHARLES LEPPERT, JR.

SUBJECT: Status of Windfall Profits Tax Legislation in the House

As of August 1, 1975, no legislation or bill has emerged from the House Committees providing for a tax on windfall profits related to decontrol of old oil.

The subject of such windfall profits legislation has arisen in both the House Committees on Interstate and Foreign Commerce and Ways and Means. The House Ways and Means Committee during its consideration of H. R. 6860, the Energy Conservation and Conversion Act of 1975, considered the inclusion of a windfall profits tax provision at the urging of the Republican committee members but the effort was defeated and not included in the bill that passed the House.

The House Interstate and Foreign Commerce Committee did not include a windfall profits provision in H. R. 7014, the Energy Conservation and Oil Policy Act of 1975. However, the Kruger Amendment to H. R. 7014 on oil pricing did provide for guidelines for a windfall profits tax. The Kruger amendment was not adopted in the House as an amendment to H. R. 7014.

Rep. Joe Waggonner informs me that the reaction he gets in the House to the windfall profits tax legislation reported in the Senate is not favorable. Waggonner says the plowback provisions in the Senate bill "are worse than none at all."

Waggonner also says the House will not accept the Senate bill but will take an active part in writing any such legislation to be sent to the President.

If the President vetoes the 6 month extension of the Emergency Petroleum Allocation Act, Waggonner states that the House Ways and Means Committee will immediately upon their return begin writing a windfall profits tax bill.