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I. Introduction

On April 2, 1980, the Crude Oil Windfall Profits Tax Act (Act) was signed into law by President Carter.[1] The most complex and controversial provisions of this Act imposed an excise tax on most domestic crude oil production.[2] This article focuses on the excise tax provisions of the Act in order to explain and illustrate their operative effects.[3]

II. Excise Not Excess

The tax imposed on the oil industry is not a tax on profits.[4] In

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1. *See* Pittsburgh Press, Apr. 2, 1980, at A-6, col. _.

2. SENATE CO. ON FINANCE, REPORT ON THE CRUDE OIL WINDFALL PROFITS TAX ACT OF 1979, S. REP. NO. 96-394, 96th Cong., 1st Sess., 180-81 (1979) (additional views of Senator Wallop) [hereinafter cited as SENATE REPORT]. Senator Wallop states that the Crude Oil Windfall Profits Tax Act is a "maddening structural complexity" that will result in "costly administrative burdens for both government and industry." *Id.* Independent observers have also described the Act as "complex." NEWSWEEK, Apr. 7, 1980, at 67 (notes that the windfall profits tax has already been dubbed the "Lawyers and Accountants Relief Act of 1980").

The controversial nature of the Crude Oil Windfall Profits Tax is evidenced by the inordinate amount of congressional debate that took place on the enactment of the tax. *See* - CONG. REC. S 16845-18866 (daily eds. Nov. 16, 1979 through Dec. 17, 1979). President Carter called its enactment "good news for the country . . . and the whole world." NEWSWEEK, Apr. 7, 1980, at 67. The Wall Street Journal, however, referred to the windfall profits tax act as a "misguided piece of legislation" that could only be the result of a "death of reason." Wall Street Journal, Mar. 27, 1980, at 26, col. _.

The windfall profits tax does not apply to all categories of oil production. Types of oil exempt from the tax include: (1) oil produced overseas, I.R.C. § 4991(a); (2) front-end tertiary oil, *id.* § 4991(b)(4); (3) oil produced by state and local government, *id.* § 4994(a); (4) oil produced by Indian tribes, *id.* § 4994(d); (5) certain qualifying charitable organizations, *id.* § 4994(b); and Alaskan oil not produced in the Sadlerochit Reservoir in Prudhoe Bay nor less than seventy-five miles from the Alaskan pipeline; *id.* § 4994(e).

The exemption for tertiary oil only applies to independent producers, *id.* § 4994(c), and even then only to a limited extent, *id.* §4994(c)(3)(B).

3. For an indepth discussion of the various provisions of the Crude Oil Windfall Profits Tax Act of 1980 [hereinafter referred to as the Act], see notes 39-111 and accompanying text *infra.*

4. SENATE REPORT, *supra* note 1, at 181 (additional views of Senator Wallop); *id.* at

fact the tax bears only a minimal correlation to oil company profits because the windfall profits tax is really an excise tax.[5] As an excise tax the windfall profits tax is, in essence, a colossal sales tax.[6]

A true windfall profits tax levies on the generation of those profits that exceed some statutorily determined reasonable level.[7] In the

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165-66 (additional views of Senator Dole); _ CONG. REC. E 3406-07 (daily ed. June 29, 1979) (remarks of Rep. Dannemeyer); *id.* at S 10694 (daily ed. July 26, 1979) (remarks of Senator Dole); *id.* at S 16845 (daily ed. Nov. 16, 1979) (remarks of Senator Dole); *id.* at S 18866 (daily ed. Dec. 17, 1979) (remarks of Senator McClure).

The so-called windfall profits tax is not really a tax on profits because it is actually an excise tax. Crude Oil Windfall Profits Tax Act of 1980, Pub. L. No. 96-235, § 4986 (codified at I.R.C. § 4986). Section 4986 provides, "An *excise tax* is hereby imposed on the windfall profit from taxable crude oil . . . ." *Id.* (emphasis added). *See also* HOUSE COMM. ON WAYS AND MEANS, REPORT ON H.R. 3919: THE CRUDE OIL WINDFALL PROFITS TAX OF 1979, H.R. REP. NO. 96-304, 96th Cong., 1st Sess., 2 (1979) [hereinafter cited as HOUSE REPORT]; SENATE REPORT, *supra* note 1, at 2.

Because the windfall profits tax is an excise tax, a strong possibility exists that an oil producer operating under a financial loss position must still pay the windfall profits tax. *See* - CONG. REC. S 17496 (daily ed. Nov. 29, 1979) (remarks of Senator McClure); *id.* at S 17134 (daily ed. Nov. 27, 1979) (remarks of Senator Bellmon); *id.* at H 6889 (daily ed. July 30, 1979) (remarks of Rep. Duncan). Responding to this anomaly, Senator Bellmon said, "This so-called windfall profit tax is not a tax on profits at all. . . . A producer of oil could very well pay a heavy tax and actually lose money and have no profits of any kind." *Id.* at S 17134 (daily ed. Nov. 27, 1979). Furthermore, Senator McClure stated,

> Once enacted the windfall profit tax will be in place even if the industry's profit in subsequent years is more moderate. And since the tax measure before us is actually an excise tax - and not a tax on profits - it will be collected even if the industry's profits were to vanish.

Id. at S 17496 (daily ed. Nov. 29, 1979).

In recognition of this possibility, the Act provides that the taxable windfall profit on any barrel of crude oil is limited to its prorata share of ninety percent of the net income of the oil producing property from which it came. Pub. L. No. 96-233, § 4988(b) (codified at I.R.C. § 4988(b)). For further discussion of the efficacy of this limitation, see note 89 and accompanying text *infra.*

5. *See* note 4 *supra.*

6. *See* HOUSE REPORT, note 4 *supra,* at 84 (additional views of Rep. Rousselot); _ CONG. REC. E 3406-07 (daily ed. June 29, 1979) (remarks of Rep. Dannemeyer); *id.* at S 17481 (daily ed. Nov. 29, 1979) (remarks of Senator Armstrong). Representative Dannemeyer states that the windfall profits tax "is an excise tax, a sales tax, the most regressive tax imaginable . . . ." *Id.* at E 3405-07 (daily ed. June 29, 1979). Senator Armstrong states: "What we have here is, basically, a sales tax." *Id.*at S 17481 (daily ed. Nov. 29, 1979).

The Congressmen are correct in their characterization of the windfull profits tax as a sales tax. A sales tax is a tax on the sale of an item of personal property usually measured by a price percentage. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2003 1966). Similarly, the windfall profits tax is levied on the sales price of each barrel of domestically produced oil less some statutory adjustments. *See* note 37 *infra.*

7. *See* REPORT OF THE STAFF OF THE JOINT COMM. ON TAXATION, ENERGY TAXATION: ALTERNATIVES FOR THE TAXATION OF INCREASED DOMESTIC OIL AND GAS PROFITS, 93d Cong., 2d Sess., 2-12 (1974) [hereinafter referred to as the STAFF REPORT OF 1974].

The STAFF REPORT OF 1974 discusses, in great detail, the differences between a true excess profits tax and an excise windfall profits tax. A true excess profits tax is described as a tax "that would be imposed on corporate earnings in excess of earnings during a base period, plus an allowance for new investment." *Id.* at 3. *Accord* HEARINGS ON THE ENACTMENT OF A "WINDFALL" OR EXCESS PROFITS TAX BEFORE THE HOUSE COMM. ON WAYS AND MEANS, 93d Cong., 2d Sess., 140-41 (statement of George Schultz) [hereinafter referred to as the HOUSE HEARINGS OF 1974]. George Schultz stated that a "classic excess profits tax" would have the following elements:

> (i) a determination of profit in excess of some base amount, (ii) the application of a high rate of tax to the excess amount, and (iii) complex exceptions designed to alleviate the penal nature of the high tax rate in situations in which the general rule determination of excess profits yielded an inequitable result.

past several congressional proposals were introduced in order to make any windfall profits tax imposed on the oil industry a true excess profits tax.[8] These proposals have usually taxed profits in excess of the amount necessary to generate a specified rate of return on capital at a very high rate.[9]

Congress, however, structured the present windfall profits tax as an excise tax rather than a true excess profits tax[10] because the price

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Id.

The major argument for the enactment of a true excess profits tax is "that it focuses directly on the problem — the excess profits themselves. Thus, assuming that normal profits can be accurately defined, the tax would be paid only by taxpayers who actually did have excessive profits . . . ." STAFF REPORT OF 1974, *supra* at 5.

The major arguments against the enactment of a true excess profits tax are: (1) such a tax becomes too complicated when provisions are enacted to insure against inequitable application; (2) it is difficult to distinguish between normal profits and excess profits; and (3) the tax only applies to corporations because it is too difficult to apply to partnerships and individuals. *Id.* at 4-5; HOUSE HEARINGS OF 1974, *supra*, at 140-41 (statement of George Schultz); *id.* at 308-09 (statement of Walker Winter on behalf of the Chamber of Commerce).

Mr. Winter stated that any attempt to define excess profit will necessarily be arbitrary. *Id.* at 309. Mr. Winter, however, then identified two methods by which to distinguish normal profits from excess profits. *Id.* One method compares current earnings to base period earnings. The other method computes the relationship of current earnings to invested capital and taxes all future earnings to the extent that they exceed this return on investment ratio. *Id.* Allegedly, both methods have flaws. The return on invested capital formula is supposedly inequitable because it does not take risks into account. The higher the risk, the higher the rate of return that can be justified. *Id.* The base period formula is supposedly inequitable because a company with poor profitability is subject to a high tax penalty if it suddenly becomes profitable since its relatively low base period earnings are based on the company's past poor performance. *Id.*

Contrary to Mr. Winter's opinion, an equitable formula for distinguishing normal profits from excess profits can be devised. *See* note 95 and accompanying text *infra*.

8. *See* _ CONG. REC. S 17485 (daily ed. Nov. 29, 1979) (amendment No. 849 to the Crude Oil Windfall Profit Tax Act of 1979, introduced by Senator McClure); HOUSE HEARINGS OF 1974, *supra* note 7, at 13-80; PROPOSED ENACTMENT OF AN ENERGY WINDFALL PROFITS TAX: HEARINGS ON SECTION 110 OF S. 2589 BEFORE THE SENATE COMMITTEE ON FINANCE, 93d Cong., 2d Sess., 3-4 (1974). For an indepth discussion and comparative analysis of different types of true excess profits bills, see HOUSE HEARINGS OF 1974, *supra* note 7, at 479-88 (statement of W.L. Henry on behalf of the American Petroleum Institute).

9. *See* HOUSE HEARINGS OF 1974, *supra* note 7, at 479-88.

10. *See* SENATE REPORT, *supra* note 4, at 6; HOUSE REPORT, *supra* note 4, at 4; - CONG. REC. S 16841 (daily ed. Nov. 16, 1979) (statement of Senator Long). The rationale behind the enactment of the windfall profits tax is that upon decontrol of domestic oil prices the oil industry will reap excessive profits. *Id.* The oil companies' profits will be excessive since domestic oil will be sold at the unreasonably high world market price set by the OPEC cartel. *Id.* Accordingly, the amount of profit attributable to the differential between the uncontrolled price of oil and the controlled price of oil is "an appropriate object of taxation." SENATE REPORT, *supra* note 4, at 6. Explaining the need for the tax, Senator Russell Long stated,

> [L]ast April the President announced his program to remove price controls from domestic crude oil.
>
> The recent price increases of the OPEC cartel, however, mean that decontrol will result in large increases in oil industry profits. If the entire rise in oil prices resulting from decontrol is allowed to remain with the oil producers, the American public may not accept decontrol. The President, therefore, as part of his decontrol program, proposed a windfall profits tax on oil producers to recapture some of these revenues.

_CONG. REC. S 16841 (daily ed. Nov. 16, 1979). *See also* HOUSE REPORT, *supra* note 4, at 76 (additional views of Rep. Fisher). Representative Fisher states that the most prudent course of congressional action is to "levy a tax on increased oil company revenues resulting from decontrol, and to use those revenues to finance research and development of alternative energy sources." *Id.*

of most domestically produced oil is currently subject to controls[11] that will soon be lifted, allowing the oil industry to reap excessive profits.[12] The tax, therefore, recaptures a large portion of these future excessive profits and uses these revenues for public purposes, taxing the difference between the former ceiling price of domestic crude oil and the higher market price obtainable upon decontrol.[13]

III. The Price Regulations

Since the windfall profits tax is imposed on the price differential that will exist between the controlled and the uncontrolled price of oil, an understanding of the Act first requires an understanding of the present system of price regulation.[14] For example, the Act often

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11. The Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751-760h (1976), *as amended by the* Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 871, *and* the Energy Conservation and Production Act of 1976, Pub. L. No. 94-385, 90 Stat. 1125, regulates the price of domestically produced oil. The dispositive provisions of the law are actually contained in federal regulations because the power to formulate price controls is explicitly delegated to the President. 15 U.S.C. § 757 (1976). *See* 10 C.F.R. §§ 212.1-.188 (1980) (price regulations issued pursuant to the federal statute). For a discussion of the price regulations, see notes 14-36 and accompanying text *infra.*

Presently, approximately 70% of domestic oil production is subject to price controls. REPORT OF THE STAFF OF THE JOINT COMM. ON TAXATION, DESCRIPTION OF H.R. 3919, H.R. 3421, AND H.R. 3474 RELATING TO WINDFALL PROFIT TAXES, 96th Cong., 1st Sess., 5 (1979) [hereinafter referred to as the STAFF REPORT OF 1979]. Because the United States imports 43% of its oil supply, price regulated oil constitutes about 40% of domestic oil consumption. *Id.*

12. *See* CONGRESSIONAL BUDGET OFFICE, THE WINDFALL PROFITS TAX: A COMPARATIVE ANALYSIS OF TWO BILLS 1 (1979) [hereinafter cited as CONGRESSIONAL BUDGET OFFICE]. The Congressional Budget Office estimated that as a result of decontrol the oil industry would reap an additional *$831.8 billion* in revenues over the next ten years. *Id.* at xvii.

Although decontrol may result in an estimated $831.8 billion in additional oil industry revenue, considerable controversy exists regarding whether the profits of the oil industry are in fact excessive. *Compare* HOUSE REPORT, *supra* note 4, at 81 (additional views of Representatives Conable, Duncan, Archer, *et al.*) *and* SENATE REPORT, *supra* note 4, at 147-49 (additional views of Senator Gravel) *with* _ CONG. REC. S 16851-54 (daily ed. Nov. 16, 1979) (remarks of Senator Metzenbaum) *and* _ CONG. REC. § 17173-74 (daily ed. Nov. 26, 1979) (remarks of Senator Metzenbaum).

It is argued that oil company profits are not excessive because on an historical basis the rate of return on investment in the oil industry is reasonable, being lower than the rate of return in the drug industry and office equipment industry. *See* HOUSE REPORT, *supra* note 4, at 81; SENATE REPORT, *supra* note 4, at 147-49. It is argued, however, that the excessiveness of the oil industry profits is evidenced by the exceptional cash-flow (liquidity) in the industry, which is generated through the utilization of such preferential accounting techniques as "successful efforts costing" and Lifo inventory valuation. *See* _ CONG. REC. S 16851-54 (daily ed. Nov. 16, 1979); _ CONG. REC. S 17173-74 (daily ed. Nov. 26, 1979). Furthermore, on the basis of the 1979 third quarter profits reported by the eighteen largest oil companies, the industry rate of return on investment averages approximately 23%, which is exceptionally high. *See* - CONG. REC. S 16853 (daily ed. Nov. 16, 1979).

13. *See* note 10 *supra.*

14. *See* HOUSE REPORT, *supra* note 4, at 82 (additional views of Representatives Conable, Duncan, Archer, *et al.*); _ CONG. REC. S 16857 (daily ed. Nov. 16, 1979) (remarks of Senator Wallop). Representatives Conable, Duncan, and Archer state,

> The complexities of this tax are such that the bureaucrats who now reside at the Department of Energy would simply be transferred lock, stock, and barrel (as well as regulation booklet) to the Department of Treasury. *The price regulations which have been held in such wide disrepute will be perpetuated through this tax.*

HOUSE REPORT, *supra* note 4, at 82 (additional views of Representatives Conable, Duncan, and Archer) (emphasis added).

makes explicit cross-references to the Department of Energy (DOE) price control regulations when defining the various categories of oil production and the tax treatment each category receives.[15]

Under the DOE price control regulations, domestic oil production is divided into three tiers:[16] "lower tier oil," receiving the lowest price;[17] "upper tier oil," receiving a higher price;[18] and third tier oil, which is not subject to price controls.[19]

Generally, lower tier oil is composed of most oil produced from a property on which production commenced before 1973.[20] The vol-

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15. *See* note 2 *supra* and note 43 and accompanying text *infra.*

16. *See* 10 C.F.R. §§ 212.1-.79 (1980). *See also* STAFF REPORT OF 1979 *supra* note 11, at 5-12; HOUSE REPORT, *supra* note 4, at 16-31; SENATE REPORT, *supra* note 4, at 30-51. Lower tier oil is defined as oil produced at a volume equal to or below the base production control level (BPCL) of a property, while upper tier oil is defined as oil produced in excess of the BPCL of a property. STAFF REPORT OF 1979 *supra* note 11, at 5; HOUSE REPORT, *supra* note 4, at 16; SENATE REPORT, *supra* note 4, at 30.

Until June of 1979 the BPCL of a property was equal to the volume of oil produced on that property in either 1972 or 1975, whichever was less. *Id.* In June of 1979, however, oil producers were given the option of having the BPCL of a property equal the average daily oil production of the property for the six months ending March 31, 1979. If an election was made the BPCL was lowered through the implementation of a statutory decline curve at a rate of 1.5% a month. *See* STAFF REPORT OF 1979, *supra* note 11, at 8-9; HOUSE REPORT, *supra* note 4, at 16-17; SENATE REPORT *supra* note 4, at 30-31; 10 C.F.R. § 212.72(c) (1980). As of January 1, 1980, the BPCL of a property is lowered at a rate of 3% per month regardless of whether a producer elected to redetermine the BPCL of his property in June of 1979. *Id.*

Given the definition of BPCL, it is easy to see that lower tier oil would be composed of most oil produced from a property that first began production before 1972. HOUSE REPORT, *supra* note 4, at 16; SENATE REPORT, *supra* note 4, at 30. Moreover, upper tier oil would be composed of oil produced from properties that first commenced production after 1972, which would include oil produced in the Prudhoe Bay region of Alaska. *See* HOUSE REPORT *supra* note 4, at 20; SENATE REPORT, *supra* note 4, at 34. Properties that first began production in 1972 would have a BPCL of zero, and, thus all production from such properties would be upper tier production. *Id.*

Lower tier oil constitutes approximately 36% of domestic oil production, or about 21% of domestic oil consumption. STAFF REPORT OF 1979, *supra* note 11, at 6. Upper tier oil represents about 20% of domestically consumed oil and about 34% of domestic oil production. *Id.*

Although no formal third tier exists, certain categories of oil are exempt from price controls. These categories include the following: incremental crude oil produced from qualified tertiary enhanced recovery projects, 10 C.F.R. § 212.78 (1980); oil produced from "stripper well properties," *id.* § 212.54; and newly discovered oil, *id.* § 212.79. For definitions of such terms as "stripper well property," "tertiary enhanced recovery project," and "newly discovered" oil, see notes 31-33 and accompanying text *infra.*

17. *See* 10 C.F.R. § 212.73, § 212.77 (1980). The ceiling price of lower tier oil is equal to the sum of: (1) the highest posted field price for that grade of oil on May 15, 1973; (2) $1.35 a barrel; and (3) certain adjustments for inflation. *Id.* On May 1979 the ceiling price for lower tier oil was estimated at $5.91 a barrel. SENATE REPORT, *supra* note 4, at 34. For a definition of "lower tier oil" see note 16 *supra.*

18. *See* SENATE REPORT, *supra* note 4, at 35. As of May 1979 the ceiling price for upper tier oil was estimated at $13.02 per barrel. *Id.* The ceiling price for upper tier oil is the highest posted field price for that grade of oil on September 30, 1975, *plus* certain adjustments for inflation *less* $1.32 per barrel. 10 C.F.R. § 212.74, § 212.77 (1979). *See also* STAFF REPORT OF 1979, *supra* note 11, at 6; HOUSE REPORT, *supra* note 4, at 20; SENATE REPORT, *supra* note 4, at 35.

19. *See* REPORT OF THE CONGRESSIONAL BUDGET OFFICE, THE WINDFALL PROFITS TAX: A COMPARATIVE ANALYSIS OF TWO BILLS 5 (1979). The Congressional Budget Office estimated that the price of uncontrolled oil averaged approximately $27.50 in November 1979. *Id.* The price of oil has since risen. For a discussion of what constitutes "uncontrolled oil," see notes 31-36 *infra.*

20. *See* note 16 *supra.*

ume of lower tier oil on a producing property is determined by computing the base production control level (BPCL) of a property.[21] Until recently, the BPCL was usually the lesser of: (1) the average daily amount of oil produced from the property in 1972, or (2) the average daily amount of lower tier oil produced in 1975.[22] Oil produced below the BPCL is lower tier oil[23] while that produced in excess of the BPCL is upper tier oil.[24]

Under the DOE price regulations upper tier oil is comprised of four major types:[25] (1) oil produced on a property in excess of the BPCL of that property;[26] (2) oil produced on a property on which production commenced after 1972 but before 1979;[27] (3) oil produced from the Sadlerochit Reservoir on the Prudhoe Bay area of the Alaskan North Slope;[28] and (4) oil produced on "marginal properties."[29] Property qualifies as a "marginal property" if the quantity of oil produced falls within the amount set for that well depth; the deeper the well, the more barrels the property can produce and still be classified as marginal.[30]

Third tier oil, which is exempt from price controls, consists of oil produced from a stripper well property,[31] oil produced through tertiary recovery techniques,[32] and newly discovered oil.[33] A strip-

21. *See id.*
22. *See id.*
23. *See id.*
24. *See id.*
25. *See* notes 26-30 and accompanying text *infra.*
26. *See* note 16 *supra.*
27. *See id.*
28. *See id.*
29. *See* 10 C.F.R. § 212.72 (1979). A property is marginal if the average daily production per well and the average completion depths of all the producing wells on the property, meet the following criteria:

Table

Average completion depth in feet	barrels per day
2,000 but less than 4,000	20 or less
4,000 but less than 6,000	25 or less
6,000 but less than 8,000	30 or less
8,000 or more	35 or less

Id. On January 1, 1980, the BPCL of marginal properties was reduced to zero. *Id.* All production from marginal properties is therefore entitled to receive the upper tier price. *Id.*

30. *See* note 29 *supra.*
31. *See* 10 C.F.R. § 212.54 (1979). A "stripper well property" is defined as a property "whose average daily production of crude oil . . . per well did not exceed 10 barrels per day during any preceding consecutive 12 month period beginning after December 31, 1972." 10 C.F.R. § 212.54 (1979). Oil produced on stripper well property is specifically exempt from price controls. *Id.*
32. 10 C.F.R. § 212.78 (1979). Tertiary oil is that additional amount of oil produced from a property through the implementation or expansion of a qualified tertiary recovery project that would not have been produced if only previous oil recovery methods employed on the property were used. 10 C.F.R. § 212.78 (1978). A qualified tertiary recovery project is one that involves one or more specified fluid, gaseous, or chemical recovery techniques that would be certifiably uneconomic at the ceiling prices imposed by the DOE pricing regulations. *Id.*
33. 10 C.F.R. § 212.79 (1979). Newly discovered oil is defined as oil that is produced from a property on which no crude oil was produced in calendar year 1978. *Id.* at § 212.79.

per well property is property on which the wells, on the average, produce ten or less barrels of oil a day.[34] Tertiary recovery involves the production of oil by forcing the oil up a well through the injection into the ground of various chemical, gaseous, or fluid solutions.[35] Newly discovered oil is that discovered after January 1, 1979.[36]

IV. The Excise Tax on Major Oil Producers

The windfall profits tax on each barrel of domestically produced oil is computed by multiplying the amount of "windfall profit" by the "applicable percentage."[37] For large integrated oil companies the applicable percentage, or tax rate, is either sixty percent, seventy percent, or thirty percent, depending upon the category of oil being taxed.[38] The seventy percent excise tax is imposed on tier one oil.[39] Tier one oil is oil that would be classified as upper tier or lower tier oil under the DOE price regulations.[40] The sixty percent excise tax is imposed on tier two oil,[41] which is defined as any oil produced from a "stripper well property" or a "National Petroleum Reserve."[42] The

34. For a discussion of the term "stripper well property" see note 31 *supra.*

35. *See* note 32 *supra.*

36. *See* note 33 *supra.*

37. I.R.C. § 4987(a). *See also Temp. Reg.* § 150.4987-1, at 45 Fed. Reg. 23387 (1980). *See also* CONFERENCE COMM., REPORT ON THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980, REP. NO. 96-817, 96th Cong., 2d Sess., 92 (1980) [hereinafter referred to as the CONFERENCE COMMITTEE REPORT]. The Conference Committee Report states that the windfall profits tax "equals the tax rate times the taxable windfall profit, which equals the selling price of the oil minus an adjusted base price and minus a deduction for State severance taxes on the windfall profit." *Id.* at 92.

For a discussion on the term "applicable percentage," see note 38 and accompanying text *infra.* For a discussion on the term "windfall profit," see notes 47-52 *infra.*

38. I.R.C. § 4987(b). *See also Temp. Reg.* 150.4987-1, at 45 Fed. Reg. 23387 (1980). For a discussion on the tax rate applied to each category of oil, see notes 39-44 and accompanying text *infra.*

The temporary regulations define an integrated oil company as a "taxpayer that both produces oil and is either a 'retailer' or a 'refiner.'" *Temp. Reg.* 150.4996.1(g), at 45 Fed. Reg. 23396 (1980). A retailer is defined as someone who sells oil or natural gas through a retail outlet operated as a franchise or through a retail outlet owned directly by the producer. *Id.* A refiner is an entity that refines more than 50,000 barrels of crude oil on any given day. *Id.*

39. I.R.C. § 4987(b). Tier one oil is defined as any oil which is not tier two or tier three oil. *Id.* § 4991(c). *See also Temp. Reg.* 150.4991-1(b), at 45 Fed. Reg. 23388 (1980). With this nebulous definition, the legislative history of the Act must be examined to determine what is meant by the term "tier one oil." The Conference Committee Report states that tier one oil is essentially any oil taxed in either tier one or tier two of the Senate version of the windfall profits tax. CONFERENCE COMMITTEE REPORT, *supra* note 37, at 92-93. The first two tax tiers of the Senate bill, however, primarily consisted of oil that would be classified as lower tier oil and upper tier oil under the DOE price control system. *See* SENATE REPORT, *supra* note 4, at 29; STAFF OF THE JOINT COMM. ON TAXATION, SUMMARY OF H.R. 3919, THE CRUDE OIL WINDFALL PROFITS TAX ACT 3 (Nov. 6, 1979). Thus, tier one oil, as defined by the Act, is composed of upper tier and lower tier oil as defined by the DOE price regulations. For a discussion on upper tier and lower tier oil as defined by the DOE regulations, see notes 16-36 *supra.*

40. *See* note 39 *supra.*

41. I.R.C. § 4987(b). *See also Temp. Reg.* 150.4987-1, at 45 Fed. Reg. 23387 (1980).

42. I.R.C. § 4991(d). *See also Temp. Reg.* 150.4991-1(b), at 45 Fed. Reg. 23388 (1980).

term "stripper well property" has the same definition under the Act as it does under the DOE price regulations.[43] Tier three oil,[44] which is composed of newly discovered oil, incremental tertiary oil, and heavy oil is taxed at a thirty percent rate.[45]

The amount of per barrel profit, which can be classified as a windfall, is calculated as follows: the sales price per barrel of oil less the "adjusted base price" and less a state severance tax adjustment.[46] The term "adjusted base price" means the base price of the barrel of crude oil multiplied by an inflation adjustment.[47] The base price per barrel of oil varies among the oil tiers.[48]

See notes 31 & 34 and accompanying text *supra* (discussion of how the term "stripper well property" is defined under the price control regulations).

43. I.R.C. § 4991(d). *See also Temp. Reg.* 150.4991-1(b), at 45 Fed. Reg. 22388 (1980). *See* notes 31 & 34 and accompanying text *supra* (definition of "stripper well property" under the DOE regulations).

44. I.R.C. § 4987(b)(3). *See also Temp. Reg.* 150.4987-1, at 45 Fed. Reg. 23387 (1980).

45. I.R.C. § 4991(e). *See also Temp. Reg.* 150.4991-1(b), at 45 Fed. Reg. 23388 (1980).

Newly discovered oil has the same meaning under the Act as it does under the pricing regulations. *See* notes 32 & 35 and accompanying text *supra.* Incremental tertiary oil is defined similarly to the definition of tertiary oil employed in the DOE regulations. I.R.C. § 4993. *See also* notes 31 & 34 and accompanying text *supra.*

The tax on newly discovered oil has been severely criticized as contrary to the whole rationale underlying the windfall profits tax. *See* _ CONG. REC. S 18179 (daily ed. Dec. 11, 1979) (remarks of Senator Dole). Senator Dole stated,

> The proposed windfall tax is an excise tax that is intended to reduce inventory profits generated by decontrol and OPEC price increases. Regardless of what one thinks about this basic rationale, it is clear that the rationale does not apply to newly discovered oil. How can one have an inventory profit on oil which has not yet been discovered? Obviously there can be no inventory profit under these circumstances and it makes no sense to impose any form of windfall profits tax on such discoveries.

Id. The tax on newly discovered oil has also been criticized on the grounds that it ignores "a fundamental, direct relationship between the price of oil, the number of wells drilled, and the oil and gas produced." *Id.* at S 18479-80 (remarks of Senator Schmitt). Drilling activity increases as a higher rate of return, resulting from a higher price, is received. *Id.* If most of the price increase is taxed away drilling activity will not expand, and the discovery of new oil reserves will be slowed. *Id.*

In addition, the placing of a windfall profits tax, even at a relatively low rate, on incremental tertiary oil has been similarly criticized. *See id.* at S 18179 (remarks of Senator Dole); *id.* at S 18181-82 (remarks of Senator Bentsen). Senator Dole stated:

> [I]t makes no sense to impose a minimum tax on incremental tertiary production. . . . The Office of Technology Assessment has estimated that with oil priced at $22 per barrel tertiary methods could add between 25 billion and 42 billion barrels of oil to existing domestic reserves, this would translate into an additional 900,000 to 1.3 million barrels per day by 1990.
>
> The Finance Committee recognized that tertiary recovery methods are extremely costly and involve relatively unproven technologies. If additional taxes are imposed on tertiary projects, they will not be initiated.

Id. at S 19179. *But see id.* at S 18185 (remarks of Senator Muskie); *id.* at S 18187 (remarks of Senator Moynihan); *Id.* at S 18189 (remarks of Senator Bradley).

Heavy oil is oil that has a high viscosity [a weighted gravity of 16 degrees API or less). I.R.C. § 4991(e)(3). *See also Temp. Reg.* 150.4991-1(b) (1980). Heavy oil is a thick tar-like substance that literally has to be mined from the earth. _ CONG. REC. S 18408-10 (daily ed. Dec. 13, 1979) (remarks of Senator Bellmon).

46. I.R.C. § 4988. *See also Temp. Reg.* 150.4981-1, at 45 Fed. Reg. 23387 (1980).

47. I.R.C. § 4989(a). *See also Temp. Reg.* 150.4981-1, at 45 Fed. Reg. 23387 (1980).

48. 45 Fed. Reg. 23385 (1980). The base price for tier one oil is the price per barrel of upper tier oil in May 1979 reduced by twenty-one cents. I.R.C. § 4989(c). *See also Temp. Reg.* 150.4989-1(b), at 45 Fed. Reg. 23387 (1980). Applying this formula, the Internal Revenue Service has determined that the base price for tier one oil is $11.01. 45 Fed. Reg. 23385 (1980).

The base price of each of these three oil tiers is termed "adjusted" because the base prices are adjusted for inflation on a quarterly basis.[49] The inflation adjustment for tier one and tier two oil equals the percentage by which the Gross National Product price deflator for the second preceding calendar quarter exceeds the deflator for the calendar quarter ending June 30, 1979.[50] The inflation adjustment for tier three oil is similar but slightly more complicated.[51] The state severance tax adjustment is computed by deducting from the sales price of a barrel of oil those state severance taxes attributable to the difference between the actual selling price of the oil and the adjusted base price of that oil, provided that the state severance tax does not exceed fifteen percent.[52]

Given the statutory definition of tier one, tier two, and tier three oil and the meaning of the terms "windfall profit" and "applicable percentage," the excise tax imposed on domestic oil produced by major companies becomes relatively easy to compute. For example, assuming a world market price of $30 per barrel,[53] a state severance tax of 12.5%,[54] and the current annual inflation rate,[55] the windfall

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It is arguable that in determining the present tier one base price of $11.01 the I.R.S. is exceeding its statutory authority. The I.R.S. predicated its base price determination on the *lowest* May 1979 upper tier ceiling price. The Conference Committee Report, however, states that the May 1979 upper tier ceiling price *averaged* $13.02. CONFERENCE COMMITTEE REPORT, *supra* note 37, at 92. The Senate Report also refers to the *average* May 1979 upper tier ceiling price as equaling $13.02 per barrel. SENATE REPORT, *supra* note 4, at 35. These reports imply that Congress intended that the *average* May 1979 upper tier base price of $13.02 be used as the starting point for all base price determinations.

The base price for tier two oil is $15.20, I.R.C. § 4989(d), and the tier three base price equals $16.55. *Id.*

A special interim rule exists for determining the base price for oil sold as either tier two or tier three oil before October 1, 1980. I.R.C. § 4989(d)(2). Under this interim rule the base prices of tier two and tier three oil are the product of the highest posted field price for such oil or, if there is no posted field price, the highest posted price from the nearest domestic oil field producing similar oil, multiplied by a fraction, the denominator of which is $35 and the numerator of which is $15.20 in the case of tier two oil and $16.55 in the case of tier three oil. *Id.* In no case can the interim base price be below the upper tier ceiling price for oil sold in May 1979 plus $1 in the case of tier two oil and plus $2 in the case of tier three oil. *Id.*

49. I.R.C. § 4989(b). *See also Temp. Reg.* 150.4989-1, at 45 Fed. Reg. 23387 (1980).

50. I.R.C. § 4989(b)(1).

51. *Id.* § 4989(c). *See also Temp. Reg.* 150.4989-1, at 45 Fed. Reg. 23387 (1980). The complication arises from adjusting the GNP price deflator for the second preceding calendar quarter upward by multiplying it by a factor of 1.005 to the nth power, in which "n" equals the number of complete calendar quarters commencing after September 30, 1979. *Id.*

52. I.R.C. § 4996(c). For a good discussion on the various forms of state severance tax adjustments proposed, see STAFF OF THE JOINT COMM. ON TAXATION, THE DESIGN OF A WINDFALL PROFIT TAX 11-12 (1979).

53. A $30 per barrel world market price is assumed for two reasons. First, the actual world market price is very close to $30 per barrel. *See* note 36 and accompanying text *supra.* Second, the Congressional Budget Office employed a $30 per barrel price assumption in all its calculations on the revenue and production effects of a windfall profits tax. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 12, at xvii n.2.

54. The state severance tax adjustment of 12.5% is assumed because that is the actual severance tax rate in Louisiana and Alaska, _ CONG. REC. S 18193 (daily ed. Dec. 11, 1979) (remarks of Senator Long).

55. The actual current annual inflation rate was chosen in order that the inflation adjustment, as calculated by the Department of Treasury, could be employed.

profits tax on a barrel of oil produced in each of the three oil tiers would be calculated as follows:

	Tier One	Tier Two	Tier Three
sales price	$30	$30	$30
adjusted base price[56]	($11.22)	($15.49)	($16.96)
state severance tax adjustment[57]	($2.35)	($1.82)	($1.63)
windfall profit[58]	$16.43	$12.69	$11.41
applicable percentage[59]	×.70	×.60	×.30
amount of tax[60]	$11.50	$ 7.61	$ 3.42

V. The Excise Tax on Independent Oil Producers

Under the Act independent oil producers are granted a preferred status.[61] An independent oil producer is someone or some en-

56. The adjusted base price for each tier is calculated by multiplying the base price, *see* note 48 *supra,* by the inflation adjustment, *see* note 50 *supra.*

57. The state severance tax adjustment for each tier of oil is the difference between the state severance tax on the sales price and the state severance tax on the adjusted base price. *See* note 52 and accompanying text *supra.* The state severance tax on the sales price is the same for all three tiers, *i.e.,* the sales price multiplied by the state severance tax rate. The state severance tax on the adjusted base price varies for each tier because the adjusted base price differs for each tier. *See* note 56 *supra.*

58. The windfall profit is calculated by subtracting the adjusted base price and the state severance tax adjustment from the sales price. *See* note 46 and accompanying text *supra.*

59. *See* notes 38-45 and accompanying text *supra.*

60. The effective tax rate on the sales price of tier one oil is 11.50/30 or 38%. The effective windfall profit tax rate on the sales price of a barrel of tier two oil is 7.61/30 or 25%. The effective tax rate on the sales price of a barrel of tier three oil is 3.42/30 or 11%.

61. I.R.C. § 4987(b)(2). An independent producer is defined as someone who is entitled to take percentage depletion under section 613A of the I.R.C. *Id.* § 4992(b)(1). Thus, as the Conference Committee Report states, in order to receive preferential treatment "a producer must not be an oil or gas retailer or an oil refiner in the taxable period." CONFERENCE COMMITTEE REPORT, *supra* note 37, at 109.

The grant of preferential treatment to the independent oil producers was first discussed in the Senate. *See* _ CONG. REC. S 17189 (daily ed. Nov. 26, 1979) [introduction of amendment 842 to the windfall profits tax act]. Senator Bentsen introduced an amendment that would have exempted the first 1,000 barrels per day of oil produced by an independent. *Id.* It was argued that the 1,000 barrel per day exemption was justified because the independent producers drill 90% of the wildcat wells in the United States and find 75% of the new oil and gas fields. *See* SENATE REPORT, *supra* note 4, at 138-40 (additional views of Senators Bentsen); *Id.* at 176 (supplemental views of Senators Boren and Wallop) _ CONG. REC. S 17190 (daily ed. Nov. 26, 1979) (remarks of Senator Bentsen); *Id.* at 17271 (daily ed. Nov. 27, 1979) (remarks of Senator Wallop). The statistics cited by the supporters of the exemption were supplied from the testimony of the Independent Producers' Association before the Senate Committee on Finance. *See* HEARINGS ON THE CRUDE OIL WINDFALL PROFITS TAX ACT: BEFORE THE SENATE COMMITTEE ON FINANCE, 96th Cong., 2d Sess., 187 (1979).

The arguments against granting the independent producers preferential treatment are twofold: First, it is argued that the independents should not receive additional tax preferences since they already "receive extraordinary advantages compared to oil companies because they receive a percentage depletion allowance." _ CONG. REC. S 17270 (daily ed. Nov. 27, 1979) (remarks of Senator Moynihan). Second, it is argued that preferential treatment for independents is not justifiable on the grounds that they are mom and pop operations that need a tax subsidy in order to compete with the larger oil companies. *Id.* at S 17274-77 (remarks of Senator Ribicoff). Many independents have hundreds of millions of dollars in gross receipts, an exceptionally high rate of return, and extraordinary cash-flow. *Id.*

tity that is only engaged in oil production, not oil refining nor oil retailing.[62] The independent oil producer receives preferential treatment because he is granted a reduced rate on the first one thousand barrels of combined tier one and tier two daily oil production.[63] Accordingly, the rate imposed on qualifying tier one oil is fifty percent,[64] and the rate imposed on qualifying tier two oil is thirty percent.[65] If an independent's daily oil production exceeds one thousand barrels a day, the one thousand barrels eligible for reduced rates will come ratably from tier one and tier two oil production.[66] The production in excess of one thousand barrels is taxed at the normal rates.[67] In addition, independents receive no reduced tax rate on the production of tier three oil.[68]

Because the independents receive preferential treatment on the first one thousand barrels of combined tier one and tier two oil production, Congress enacted a provision that precludes inter-company property transfers designed solely to obtain the preferential rates.[69] Under this provision, if an independent acquires a property that produces tier one or tier two oil from a major oil company, or from an independent that produces more than one thousand barrels of oil a day, all oil produced on the transferred property will be ineligible for the preferential rates.[70] Furthermore, to prevent the creation of artificial entities, each of which would be entitled to a preferential rate on the first one thousand barrels of daily oil production, section 4992(e) of the Act provides that all related parties will be aggregated and forced to share a single one thousand barrel preference.[71] Accordingly, a related group is defined as a family, a group of controlled corporations, a group of entities under common control, or a family and all entities in which that family has a beneficial interest of 50 percent or greater.[72]

The windfall profit tax imposed on an independent is calculated in the same manner as it is for a major oil company, by multiplying the amount of profit categorized as a windfall by the applicable tax rate.[73] For example, assume that the sales price of a barrel of oil is

62. I.R.C. § 4992(b). *See also* CONFERENCE COMMITTEE REPORT, *supra* note 39, at 109.
63. I.R.C. § 4987(b)(2). *See also Temp. Reg.* 150.4987.1, at 45 Fed. Reg. 23387 (1980).
64. *Id.*
65. *Id.*
66. *Id.* § 4992(c)(2). *See also Temp. Reg.* 150.4987.1, at 45 Fed. Reg. 23387 (1980).
67. I.R.C. § 4992(a). *See also Temp. Reg.* 150.4992-1, at 45 Fed. Reg. 23388 (1980).
68. I.R.C. § 4987(b)(3).
69. *Id.* § 4992(d)(3). *See also Temp. Reg.* 150.4992-1(d)(3), at 45 Fed. Reg. 23388 (1980). The only exceptions to this prohibition on property transfers are: (1) transfers of property at death; (2) transfers when the beneficiaries of a trust are changed; and (3) any transfer in which the transferor and the transferee are forced to share a single 1,000 barrel preference. *Id.*
70. *Id.*
71. *Id.* § 4992(e).
72. *Id.*
73. *See* note 37 and accompanying text *supra.*

$30, that the state severance tax is 12.5%, that the inflation adjustment is based on the current annual inflation rate,[74] and that the independent produced one thousand barrels of tier one oil and two thousand barrels of tier two oil. Given these facts the windfall profits tax would be calculated as follows:

	Preferred Tier One	Regular Tier Two	Preferred Tier Two	Regular Tier Two
sales price[75]	$9,990	$20,010	$20,010	$39,990
adjusted base price[76]	($3,736)	($7,484)	($10,332)	($20,648)
state severance tax adjustment[77]	($783)	($1,567)	($1,214)	($2,426)
windfall profit[78]	$5,471	$10,959	$8,464	$16,916
applicable percentage[79]	×.50	×.70	×.30	×.60
amount of tax[80]	$2,736	$7,671	$2,539	$10,150

VI. Administrative Provisions

The administrative provisions of the Act are relatively straightforward. The first purchaser of any domestically produced barrel of oil is required to withhold the amount of the windfall profit tax from the purchase price.[81] The amount withheld by the purchaser is determined on the basis of information supplied by the producer.[82]

74. For a discussion of why these particular assumptions are employed see notes 53-55 and accompanying text *supra.*

75. Sales price is determined by multiplying the number of barrels in each oil tier by the assumed sales price of $30 per barrel. Because the Act provides that the barrels entitled to preferred rates come proportionately from tier one and tier two, it is apparent that 333 barrels of tier one oil are entitled to preferred treatment and 667 barrels of tier two oil are entitled to preferred treatment (given the assumption of 1,000 barrels of tier one and 2,000 barrels of tier two).

76. The adjusted base price per barrel of tier one and tier two oil was determined at note 56 *supra.* If you multiply the tier one and tier two adjusted base prices by the appropriate number of barrels in each of the above listed oil tiers, you arrive at the computed number. *See* note 75 *supra.*

77. The state severance tax adjustment per barrel of tier one and tier two oil was determined at note 57 *supra.* Multiply the tier one and tier two severance tax adjustment by the number of barrels in each of the above listed tiers, *i.e.,* 333 in preferred tier one, 667 in regular tier one, 667 in preferred tier two, and 1,333 in regular tier two, to arrive at the computed numbers.

78. Windfall profit is calculated by subtracting the adjusted base price and the state severance tax adjustment from the sales price. *See* note 46 and accompanying text *supra.*

79. The applicable percentages or tax rates imposed on independent production are discussed at the text accompanying notes 64-68 *supra.*

80. The effective tax rate on total tier one production is 34.6% of the sales price of a barrel of tier one oil. This rate was calculated as follows: Total tax on tier one $2,736 + $7,671 = $10,407. $10,407/$30,000 (total sales price) = 34.6%. The effective tax rate on tier two production, as a percentage of the sales price, is 21%, calculated as follows: Total tax on tier two production is $2,539 + $10,150 = $12,689. $12,689/$60,000 (total sales price) = 21%.

81. I.R.C. § 4995(a). *See also Temp. Reg.* 150.4995.1(a), at 45 Fed. Reg. 23391 (1980).

82. I.R.C. § 4995(a)(2). This section provides that the purchaser will withhold an amount that shall be determined on the basis of a certification furnished to the purchaser under I.R.C. § 6050C. *Id.* I.R.C. § 6050C requires a producer to furnish the purchaser with

The producer is required to provide the adjusted base price of the oil purchased and the corresponding tier and category to which the oil belongs.[83] In the case of an integrated oil company, a constructive sales price is imputed if no inter-company sales exist or refining is likely to commence on the producing premises.[84] The integrated company must then withhold the tax based upon this imputed price.[85]

Although windfall profit tax returns must be filed quarterly and once at the close of the year,[86] payment of the tax is to be made by independent producers within forty-five days after the calendar month in which the oil was sold[87] and twice a month by integrated oil companies.[88]

VII. Miscellaneous Provisions

The Act contains three important provisions that do not fall into any cognizable category. First, the windfall profit tax imposed on the production of an oil property cannot exceed ninety percent of the taxable income derived from that property.[89] Under this section, taxable income is computed without any deductions for depletion, intangible drilling expenses, qualified tertiary injectant costs, or the windfall profit tax.[90] Additionally, the ninety percent limitation does not apply for the purposes of withholding the windfall profits tax.[91] Second, the windfall profits tax is deductible in calculating the federal income tax.[92] Last, the windfall profits tax terminates once the total revenue obtained from the tax equals 227 billion dollars or in the year 1990.[93]

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the adjusted base price of the oil sold, the tax tier to which the oil belongs, and any other information the Secretary of the Treasury might require pursuant to regulation. I.R.C. § 6050C.

83. I.R.C. § 6050C. *See* note 28 *supra.*

84. *Id.* § 4988(c).

85. *Id.* § 4995(a). *See also Temp. Reg.* 150.4995-1, at 45 Fed. Reg. 23391 (1980).

86. I.R.C. § 4995(a)(5) & (6). The purchaser must make quarterly returns. *Id.* Producers must file annual returns. *Temp. Reg.* 150.4997-1, at 45 Fed. Reg. 23397 (1980).

87. I.R.C. § 4995(b).

88. *Id.*

89. *Id.* § 4988(b). This 90% net income limitation raises problems because it is calculated with respect to a "property" and not with respect to the over all profitability of the oil producing entity. Even small oil companies usually own several oil producing properties. Even if one oil property is producing oil at a profit substantial losses from other property may actually put the producer in a net loss position. The windfall profits tax will still have to be paid, however, on the oil produced from the "profitable" property. The possibility that an oil producer would have to pay the windfall profits tax although in a loss position was even recognized by a proponent of the tax. *See* _ CONG. REC. S 17481-82 (daily ed. Nov. 27, 1979) (remarks of Senator Chaffee in response to queries from Senator Armstrong).

90. I.R.C. § 4988(b).

91. *Id.* § 4995(a)(2)(B).

92. *Id.* § 4988(b).

93. *Id.* § 4990.

VIII. Critique and Conclusion

The windfall profits tax is an excise tax and not a true excess profits tax. As an excise tax, it does not take into account the actual profitability of the oil industry. Conceivably, an oil company could be in a loss position and still have to pay the windfall profits tax. Such a result is preposterous; logic dictates that a tax on "windfall profits" should only be imposed if profits in fact exist.

Because of this intrinsic structural defect, the Act should be amended to reflect a true excess profits tax.[94] For example, a seventy percent tax rate should be imposed on those oil company profits that are in excess of those profits sufficient to generate a twelve percent rate of return on stockholder's equity.[95] This true excess profits tax would bear a complete correlation to the "excess" amounts of oil company profits and could never render the absurd result of taxing a loss corporation.[96] This needed amendment would also satisfy any populist urge to preclude the oil companies from "profiteering," yet at the same time foster continued energy production by permitting a reasonable rate of return upon oil company investment.[97]

Notwithstanding any belief that the present excise tax is preferable to a true excess profits tax, several criticisms about the present Act remain. The present Act is exceedingly complex.[98] Accordingly, the complexity of an excise windfall profits tax has led some commentators to suggest that a windfall profits tax should not be enacted.[99] Instead, these commentators suggest that the tax subsidies presently accorded the oil industry, such as percentage depletion and the option to immediately expense intangible drilling costs, be eliminated.[100] The elimination of these tax subsidies would generate substantial tax revenue and would simplify, rather than complicate, the Internal Revenue Code.[101]

Additionally, placing an excise tax on newly discovered oil is not in keeping with the underlying purposes of the Act.[102] The rationale behind the Act is that once the price of oil is decontrolled the oil industry will reap a windfall when the price of oil rises to the

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94. *See* notes 7-9 and accompanying text *supra* (discussion of what constitutes a true windfall profits tax).

95. This form of true excess profits tax has already been suggested. *See* note 8 *supra*.

96. A loss corporation could not be subject to the excess profits tax because payment of the tax would be conditional on profit generated and not, as in the present windfall profits tax, on sales made.

97. For a discussion concerning what constitutes a reasonable rate of return, see SENATE REPORT, *supra* note 4, at 147-49 (additional views of Senator Gravel).

98. *See* note 2 *supra*.

99. HOUSE HEARINGS OF 1974 *supra* note 7, at 637-41 (statement of Gerard M. Brannon); *Id.* at 803-04 (statement of Robert M. Brandon, Director of Tax Reform Research Group).

100. HOUSE HEARINGS OF 1974 *supra* note 7, at 803-04.

101. *Id.*

102. *See* note 45 *supra*.

world level.[103] Placing a tax on newly discovered oil, however, does not follow this rationale since no windfall can be had on oil that was never controlled.[104] Finally, an excise tax should not be placed on incremental tertiary oil and heavy oil. The production of tertiary oil and heavy oil requires high cost technologies. Thus, unless a large amount of revenue is retained by the producers of these types of oil, no incentive to continue production will exist because the companies will be unable to recoup their investment.

The complexity of the Act, its design as an excise tax rather than as a true excess profits tax, and the failure to take into account some basic oil economics, all militate against a favorable review. In fact, in its present form the Act operates contrary to both principles of equity and economics.

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103. *Id.*
104. *Id.*