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Oil Industry Financial Performance and the Windfall Profits Tax

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Summary

Over the past 10 years, surging crude oil and petroleum product prices have increased oil and gas industry revenues and generated record profits, particularly for the top five major integrated companies (also known as the "super-majors"): Exxon-Mobil, Royal Dutch Shell, BP, Chevron, and Conoco/Phillips. These companies, which reported a predominant share of those profits, generated more than $100 billion in profits on nearly $1.5 trillion of revenues in 2007. From 2003 to 2007, revenues increased by 51%; net income (profits) increased by 85%. Oil output by the five majors over this time period declined by more than 2%, from 9.85 to 9.63 million barrels per day. Being largely price-driven, with no increase in output, and with little new production resulting from increased oil industry investment, many believe that a portion of the increased oil industry income over this period represents a windfall and unearned gain, i.e., income not earned by any additional effort on the part of the firms, but due primarily to record crude oil prices, which are set in the world oil marketplace.

Numerous bills have been introduced in the Congress over this period to impose a windfall profits tax (WPT) on oil. Most of the bills were introduced in the 109th and 110th Congresses, after the enactment of the Energy Policy Act of 2005, which provided oil and gas industry tax incentives, in addition to the industry's traditional tax subsidies. An excise-tax based WPT would tax only domestic production, and like the one in effect from 1980-1988, would increase marginal oil production costs, which theoretically could reduce domestic oil supply, and raise petroleum imports, making the United States more dependent on foreign oil, undermining goals of energy independence and energy security. By contrast, an income-tax based WPT would be more economically neutral (less distortionary) in the short-run: sizeable revenues could be raised without reducing domestic oil supplies. Neither the excise-tax based or income-tax based WPT are expected to have significant price effects: neither tax would increase the price of crude oil, which means that refined petroleum product prices, such as pump prices, would likely not tend to increase.

In lieu of these two types of WPT, an administratively simple way of increasing the tax burden on the oil industry, and therefore recouping some of any excess or windfall profits, particularly from major integrated producers, would raise the corporate tax rate by, for instance, repealing or reducing the domestic manufacturing activities deduction under IRC § 199. This deduction is presently 6% of a firm's net income) and is available generally to all domestic manufacturing businesses (service firms are excluded), including almost all oil firms. Repealing this deduction for the major integrated oil companies, and freezing it at 6% for the remaining qualifying oil companies is estimated by the Joint Committee on Taxation to generate about $10 billion over 10 years.

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Oil Industry Financial Performance and the Windfall Profits Tax

Introduction

Over the past 10 years, the price of crude oil has been increasing, volatile, and has recently attained record high levels. The results of those price increases, which led to high gasoline prices, have been a weakening of the U.S. economy, and financial hardship for many American families who have also been buffeted by the housing slowdown, the credit crunch, rising unemployment, and other economic factors. While much of the American economy has suffered as a result of high oil prices, those prices generated record profit levels for the oil industry. Five companies, Exxon-Mobil, Royal Dutch Shell, BP, Chevron, and ConocoPhillips earned a predominant share of those profits

Record oil and gas industry profits have raised the concern of many public policy experts and federal policymakers, including many in Congress, who have questioned whether these profits were justified, or whether they constituted a "windfall" to the industry: an excessive, unearned, and unfair gain. Important factors in considering this issue might include the ultimate source, or reason, for the price increases, and what was the industry's role in generating them, i.e., whether it was through the direct result of the industry's efforts, in terms of employing its resources, decision-making, or risk-taking, or whether it was the result of fortuitous factors and events. Also important to the public policy question might be the actual size of the profits and what the industry did with them. If an industry invests profits into increased production capacity, the increased supply may ultimately cause prices to fall and the profits to dissipate. As the analysis in this report shows, the experience between 2003 and the first half of 2008 is not encouraging. Investments in oil exploration and development have not managed to keep company output from declining by some 7% over the five-year period.

Numerous bills have been introduced in the Congress over this period to tax the oil and gas industry's record profits. These bills generally take one or more of four approaches. First, some bills have proposed rescinding, or taking back, the tax incentives or subsidies enacted under the Energy Policy Act of 2005 (EPACT 05, P.L. 108-58), which not only expanded preexisting oil and gas industry tax subsidies, but enacted several new ones.[1] To be sure, EPACT05 also reinstated two excise taxes

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[1] In the 110th Congress H.R. 86, H.R. 498, H.R. 1945, and S. 115 propose to rescind EPACT's oil and gas industry tax breaks.

on petroleum that were larger than the tax subsidies,[2] but policymakers asked: 1) Why should the federal government provide *any* subsidies at a time when oil and gas prices and oil and gas industry profits are not only rising, but reaching higher and higher record levels; and 2) Why should the level of oil and gas industry subsidies be increased for an already profitable industry at a time when consumers and energy intensive industries (trucking, airlines, etc.) and the general economy are burdened by the high crude oil and gasoline prices?

Another policy option proposed in Congress to raise the tax burden on the oil and gas industry would repeal or cutback the pre-existing oil and gas industry tax subsidies, i.e., those that predated EPACT05, some of which were also expanded under EPACT05, and which generally are still in effect. Since the inception of the federal income tax system in the early 20th Century, the oil and gas industry has benefitted from sizeable — some estimates exceed $100 billion in real terms — federal tax subsidies, primarily for upstream activities such as exploration and development, and extraction and production, as compared to the downstream activities such as refining and marketing. For example, the domestic oil and gas industry is able to expense, i.e., write off in the first year (as compared to capitalize), intangible drilling costs (IDCs), and independent producers qualify for the percentage depletion allowance, rather than cost depletion. And while these traditional subsidies have been significantly pared back over the years, and are not now large relative to the size of the industry, some feel that no subsidies should be available to the industry at a time of surging record profits.

A third policy option that would raise taxes on oil and gas is to amend or reform certain income tax code provisions that, although legally and economically not subsidies — they would not be defined as subsidies in the tax expenditure sense by the Joint Committee on Taxation — may confer undue or disproportionate (and unnecessary) tax benefits to the oil and gas industry.[3] As an example, some bills propose to repeal the industry's use of the "last-in/first-out" (LIFO) system of inventory accounting under IRC § 472. This method values the goods sold as the most recent inventory purchase. During a period of rising prices, this method of inventory accounting increases production costs and reduces taxable income and tax liabilities.[4]

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[2] EPACT05 reduced taxes (provided additional tax subsidies) valued at $2.633 billion over 11 years. It also reinstated two excise taxes: the Oil Spill Liability Trust fund tax, and the Leaking Underground Storage Tank Trust fund tax, both of which are imposed on oil refineries. According to the Joint Committee on Taxation, over 11 years, the value of the tax increase was $2,857 million, $224 million ($2,857-$2,633) more than the tax cuts Also, the Tax Increase Prevention and Reconciliation Bill of 2006 (P.L. 109-222), enacted on May 17, 2006, reduced one of the industry's tax subsidies, i.e., it increased taxes on the oil industry, by about $189 million.

[3] There is an important economic distinction between a subsidy and a tax benefit. As is discussed elsewhere in this report, business firms, including oil and gas companies, generally receive a variety of tax benefits that are not necessarily targeted subsidies (or tax expenditures) because they are available generally.

[4] See CRS Report RL33578 for more detail.

A second example is the proposed reform of the foreign tax credit. Many of the major energy tax bills that the Congress has considered over the last two years proposed to reform the tax treatment of foreign oil and gas extracting income (FOGEI) and foreign oil-related income (FORI). The proposed reforms are apparently focused on reducing instances in which such income is not measured correctly (overstated), so as to overstate foreign income taxes, and overstate their foreign tax credits, which tends to reduce the U.S. tax liability (i.e., the tax on U.S. source income).

Finally, a fourth option — the one that is discussed in this report — is to impose a windfall or "excess" profits tax i.e., a supplemental or additional tax on the oil industry, one based on windfall or excess profits in addition to other income or other taxes that the industry might pay. While some congressional Legislators envision this as a totally new type of tax on windfall gains, others would model it after the windfall profits tax on oil that existed from 1980 to 1988, while still others propose a higher corporate income tax burden, either through raising the corporate rate or eliminating deductions. Either way, a windfall profit tax would be in addition to the current tax on corporate and business income that applies to the oil and gas industry, and which tax profits at rates as high as 35%.[5]

This report discusses the fourth option: the windfall profit tax. The first section analyzes the major oil companies profit performance, particularly from 2003 to 2008, both in terms of earnings and how those earnings have been used. The second section is a brief legislative history of windfall profit tax proposals and legislation in both the 109th and 110th Congresses. The third section analyzes the idea of a windfall profits tax, including experiences with the tax of the 1980s, its viability, and potential role in the tax system and economy.

Oil Industry Financial Performance

During the Fall/Winter of 1998/1999, the spot market price of West Texas Intermediate (WTI) crude oil hovered between $11 and $12/barrel.[6] In July 2003, it was $30.75 per barrel. Five years later, in July 2008, the spot market price of WTI was $133.37, an increase of 334% in five years, and more than 1,000% over the 1998 trough. In June 2008, the spot market price reached the all-time high of $147/barrel.[7] This nearly 10-year period of generally increasing oil prices began after a poor year for profitability in the oil industry, 1998, and included another poor year, 2002. The

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[5] As discussed below on p. 18, the marginal corporate income tax rate is presently less than 35% for most domestic manufacturing activities due to the 6% domestic manufacturing activities deduction, which typically applies to large corporations such as oil and gas producers and refiners, and which is equivalent to a marginal corporate income tax rate of 32.9% (35% x 0.94) rather than 35%. In addition, present federal tax law imposes a minimum tax on corporations (and individuals) to the extent that their minimum tax exceeds their regular tax liability.

[6] The low of $10.82/barrel was reached on December 10, 1998.

[7] The $147 is in nominal or current dollars; crude oil prices also reached a record high in real terms, or inflation adjusted terms.

increase in prices that began in late 2003 seemed to be largely unanticipated by the industry. It has since been attributed primarily to 1) a growing world economy, particularly the ascending economies of China and India, and 2) declining excess production capacity, particularly within OPEC (Organization of Petroleum Exporting Countries) producers. As the price of oil rose, company revenues, net incomes, and income taxes paid also rose, with Exxon-Mobil eventually becoming the most profitable corporation in the history of American industry.

The oil industry is composed of thousands of companies, ranging from the major integrated oil companies with operations around the globe, independent producers (which can be very large), to relatively small oil service and equipment companies. The rise in oil prices over the past 10 years — particularly over the past five years — has enhanced the profitability of virtually all sectors of the industry, directly, or indirectly.[8]

Table 1 reports three measures of the financial performance of the domestic oil and gas industry in the United States, using data for the largest oil and gas producing companies as reported by Oil Daily. Note that while industry revenue (price times output), increased by 63%, from $1.1 trillion to nearly $1.9 trillion from 2003 to 2007, industry profits (net income) more than doubled, increasing from $72 billion to more than $150 billion over this time period.

Table 1. Financial Data for Oil Industry Firms, 2003-2008
(billions of dollars)

Income Statement Item	2003	2004	2005	2006	2007	2008 First Half
Revenue	1,144.6	1,396.4	1,620.2	1,718.9	1,868.4	1,253.9
Net Income	72.4	100.7	139.8	162.8	155.8	87.6

Source: Profit Profile Supplements, Oil Daily.

Note: The companies included in Table 1 are ExxonMobil, Royal Dutch Shell, BP, Chevron, ConocoPhillips, Marathon, Hess, Occidental, Murphy, Encana, Apache, Devon, Andarko, XTO, EOG, Noble, Chesapeake, Pioneer, Newfield, Valero, Sunoco, Tesoro, Western, Frontier, Holly, and Alon and the companies they merged with, or acquired, since 2003.

The Super-Major Integrated Oil Companies

While the oil and gas industry's good fortune has been extensive and widespread, it has also been concentrated among industry's largest firms. **Table 2** uses more recent financial data to show that the performance of the industry is dominated by the five largest firms (the "super-majors"): ExxonMobil, Royal Dutch

[8] There are, of course, exceptions. Stone Energy Corporation, for example, lost money (they reported negative net income) during 2006. See Standard and Poor's. *Industry Surveys: Oil and Gas, Production and Marketing.* March 20, 2008. P. 48.

Shell, BP, Chevron, and ConocoPhillips.[9] For the first half of 2008, the net income of these five firms constituted 90% of the total net income of the nine firms considered to be integrated oil companies operating in the United States. Of the set of twenty-six firms, which includes integrated oil companies, independent oil and gas producers, and independent refiners and marketers, the five major firm's net income was 82% of the total. As a result of the dominant position of these five firms in the industry, the data in the remainder of this report are limited to their financial performance.

Table 2. Revenue of the Top Five Major Integrated Oil Companies, 2003-2008
(billions of dollars)

Company	2003	2004	2005	2006	2007	2008 First Half
ExxonMobil	246.7	298.0	371.0	377.6	404.5	254.9
Shell	269.1	265.2	306.7	318.8	355.8	245.7
BP	236.0	294.8	253.6	270.6	291.4	201.1
Chevron	120.0	155.3	198.2	210.1	220.9	148.9
ConocoPhillips	105.0	136.9	183.4	188.5	194.5	129.9
Total	**976.8**	**1,150.2**	**1,312.9**	**1,365.6**	**1,467.1**	**980.5**

Source: Profit Profile Supplements, Oil Daily.

The data in **Table 2** show that the revenue of the five major firms increased. This increase was caused primarily by the increasing prices of oil and petroleum products. Total revenue is measured as price times the quantity of goods and services sold. In the case of the five major oil companies over this period, the increase in revenues was largely price-driven, with quantities produced largely stagnant. For example, in 2003, ExxonMobil produced 2.59 million barrels per day (b/d) of crude oil, and in 2007, ExxonMobil produced 2.61 million b/d, an increase of less than 1/10th of 1%. In general, the five major oil firms were unable to produce more crude oil and petroleum products in response to the higher prices as shown in **Table 3**. Note that only one company, BP, produced more crude over this period, and that, for the five firms as a whole, output declined by 2.2% from 2003-2007, and by 5.8% through the first half of 2008.

[9] ExxonMobil, Chevron, and ConocoPhillips are U.S. based firms. BP is a British firm, and Royal Dutch Shell is a Dutch and British firm, both with U.S. subsidiaries.

Table 3. Crude Oil Production by the Major Oil Companies

(million barrels per day)

Company	2003	2004	2005	2006	2007	2008 First Half
ExxonMobil	2.51	2.57	2.52	2.68	2.61	2.43
Shell	2.39	2.25	2.09	2.03	1.82	1.73
BP	2.12	2.53	2.56	2.47	2.41	2.43
Chevron	1.81	1.71	1.67	1.73	1.76	1.65
ConocoPhillips	1.02	0.90	0.91	1.13	1.03	0.94
Total	**9.85**	**9.96**	**9.75**	**10.04**	**9.63**	**9.18**

Source: Profit Profile Supplements, Oil Daily.

The revenue data for the first half of 2008 reflects the sharp increases in the price of oil observed during the first six months of the year, with the price of WTI reaching $147 per barrel in June. During the third quarter of 2008, the price of oil declined from the June peak, making extrapolation of the first half 2008 to the entire year uncertain. The likely result is that revenue increases were predominately price-driven, which, as noted, is important in considering a windfall profit tax.

Table 4. Net Income of the Major Oil Companies, 2003-2008[a]

(billions of dollars)

Company	2003	2004	2005	2006	2007	2008 First Half
ExxonMobil	21.5	25.3	36.1	39.5	40.6	22.6
Shell	12.7	18.5	22.9	25.4	27.6	15.7
BP	16.4	16.2	19.3	22.2	17.3	13.4
Chevron	7.2	13.3	14.1	17.1	18.7	11.1
ConocoPhillips	4.7	8.1	13.5	15.5	11.9	9.6
Total	**62.5**	**81.4**	**105.9**	**119.7**	**116.1**	**72.4**

Source: Profit Profile Supplements, Oil Daily.

a. Data reflect consolidated worldwide earnings of these firms. Data segmenting net income on the basis of geographical earnings are not available.

Table 4 shows the net income of the five major oil companies over the period 2003 to 2008. While revenues increased by 51% from 2003 to 2007, net income increased by 85%. These percentages suggest that price increases for crude oil and petroleum products increased at a higher rate than costs and taxes for the five major

firms. Analogously to the observed increase in revenues, the increase in net income experienced by the five firms was largely price-driven.

The previous measures of financial performance focus on absolute levels: absolute levels of revenue, and absolute net income. Perhaps a better measure of performance is the profit rate, which may also be measured in variety of ways. One measure of the profit rate is the operating margin, essentially net income divided by revenue. As a result of the increasing price of oil driving up both total revenues and net incomes, the return on revenue, or the profit rate, increased slightly for both the major integrated oil companies as well as for the industry as a whole, as shown in **Table 5.** This indicator of industry performance is not out of line with the rate in the manufacturing industry generally, which in 2007 has a profit rate of 8.9%. However, a more appropriate measure of the relative profit rate may be the rate of return on equity (ROE). Using this measure of profit rate, the oil and gas industry's ROE was, on average, significantly greater than the ROE for the manufacturing industry generally. According to the Energy Information Administration (EIA), the oil and gas industry earned a 27% ROE in 2006, down slightly from 2005, but more than 9% higher than the average ROE for all manufacturing companies.[10]

Table 5. Average Profit Rates In the Oil Industry, 2003-2008
(percent)

	2003	2004	2005	2006	2007	2008 First Half
Major Integrated Companies	6.4	7.0	8.0	8.7	7.9	7.4
All Oil Industry	6.3	7.2	8.6	9.5	8.4	7.0

Source: Profit Profile Supplements, Oil Daily. CRS calculations.

For the entire 2000-2006 period, the oil and gas industry's ROE averaged 7 percentage points higher than manufacturing's ROE, while for the 1985-1999 period, the oil and gas industry's ROE was only 2 percentage point higher. By this measure, the industry's recent high profits, measured both in absolute terms, and relative to ROE, suggest the presence of excess or windfall profits.

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[10] The EIA reports these data in its annual reports for the Financial Reporting System (FRS), which are based on detailed financial and operating data and information submitted each year to the EIA on Form EIA-28, the Financial Reporting System (FRS). The FRS Companies derive the bulk of their revenues and income from petroleum operations, which include natural gas production. A majority of these companies are multinational, with 40% percent of the majors' net investment located abroad. EIA supplements the FRS data with additional information from company annual reports and press releases, disclosures to the U.S. Securities and Exchange Commission, news reports and articles, and various complementary energy industry data sets. See Energy Information Administration. *Performance Profiles of Major Energy Producers (Issues December 2007, March 2006, February 2004, and January 2002).*

The data in **Table 1**, **Table 2**, **Table 3**, and **Table 4** characterize an industry that was unable to respond to the market signal of higher price by increasing output as predicted by economic theory. As a result, their revenues and net incomes increased proportionately, possibly supporting the judgement that those profits constituted a "windfall," at least in the sense that they were not earned through output expansion or improvement, risk-taking, or investments leading to cost reductions in production. However, the data in **Table 5** could be taken to suggest that the major oil companies did not earn more net income respective to the value of their product, than many other industries, and the value of their product was determined on a world market, beyond their control. From this point of view oil was attaining its fair market value.

The net income data presented in **Table 4** was earned in three sectors of the industry: upstream operations (the exploration and production of oil and natural gas), downstream operations (the refining, transportation, distribution, and marketing of petroleum products, including motor gasoline, diesel, jet fuel, and other petroleum products), and chemicals and all other "non-oil" activities. Over time, the relative importance of these sectors may shift in terms of potential to generate net income. For example, while downstream activities were very strong in 2005 and 2006, they weakened in 2007 and 2008. In terms of general corporate income taxation, this cyclical pattern of change is likely to have little effect, since it is over-all corporate net revenues that form the tax base. In terms of possible windfall profit taxation, however, this cyclical pattern of change might be important as it is net-income from crude oil ownership and production that is likely to have a windfall gain, or "unearned" income component.

Use of Profits[11]

In economic theory, when firms earn returns in excess of the market rate of return, they are likely to re-invest in their businesses to expand output and improve their technologies to meet the challenge of new firms that might choose to enter the industry as new competitors. In the theory of corporate finance, firms that seek to maximize shareholder value use profits to invest in business projects that offer a higher potential rate of return than that currently earned by the firm.

Increased Investment. Capital expenditures for the five major oil companies were $48.6 billion in 2003, $48.7 billion in 2004, $57.2 billion in 2005, and more than $80 billion in 2006 and 2007, for a total increase of 77% over the five-year period. This increase is proportionately less than the increase in net income over the period. Part of total investment funding is directed to environmental compliance for both facilities and products, and does not increase capacity to bring petroleum products to the market.[12] It is well known that the five companies have not committed to the construction of a new refinery in the United States since the 1970s, though existing refineries have been expanded and upgraded. When the demand for gasoline

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[11] This section of the report is based on CRS Report RL34044, *The Use of Profit by the Five Major Oil Companies,* by Robert Pirog. See CRS Report RL34044 for a more complete analysis of this topic as well as more complete data.

[12] The Energy Information Administration, *The Impact of Environmental Compliance Costs on U.S. Refining Profitability 1995-2001,* May 2003.

exceeds the ability of the U.S. refineries to produce, the gap has been filled with imported product.

Increased Oil Output. Although the oil industry, and the five major firms have invested in exploration, development, and production, those investments have not met with noticeable success. **Table 2** shows that the companies have failed to expand, or even maintain their oil production rates.

Cash Reserves and Dividend Payouts. The major oil companies accumulated cash reserves from 2003 through 2007. The five firms held $19.4 billion in cash in 2003 and $52.27 billion in 2007, an increase of almost 170%. While cash holdings declined in 2007, compared to 2006, this was the result of reduced balances at only one company, Chevron.[13] The other four major oil companies continued to build their cash balances.

From one point of view, cash balance accumulation gives firms flexibility and positions them to take advantage of opportunities quickly. It is also likely that the rapid increase in the price of oil and profits from 2003 to 2007 exceeded corporate plans and strategies on how to use it. However, the theory of corporate finance suggests that extraordinary cash returns to shareholders are appropriate only when the management feels that individual shareholders are likely to have access to higher return investment alternatives than management can identify. Activities that represented direct returns to stockholders, in the form of increased dividend payments and stock buy-backs also claimed a share of earned profits.

Legislative History of Windfall Profits Tax Proposals

Almost from the outset of the surge in crude oil and petroleum product prices, many in Congress became concerned over the level of oil industry profits, and bills were introduced to raise taxes on the oil and gas industry by imposing some type of windfall profits tax. These proposals are viewed as a way of generating tax revenue to fund subsidies for low income persons and offset the burden of recent high petroleum prices, and programs for energy conservation and alternative and renewable fuels. Also, they are viewed from the perspective of basic equity or fairness — the overall distribution of the tax burden could be viewed as being more fair when taxes on the record, unearned incomes of business enterprises are used to reduce the tax burden of lower income persons burdened by the higher prices that contributed to those record earnings.

The concept of a windfall profits tax is not new; a tax on windfall, or excess, business profits has been one the instruments of fiscal policy, used by both state and federal governments, whenever business profits either rise too fast or rise to levels that are either considered too high, above “normal” or fair, or which reflect “excessive” rates of return. At the federal level, however, such taxes have been used

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[13] Balance sheet data for the five major oil companies can be obtained at [http://www.hoovers.com].

sparingly — being viewed as extraordinary measures, their use limited to wartime or other periods characterized by economic emergencies and instabilities such as hyper-inflations. Such was the case with the surtax on business profits imposed as a temporary measure to control large profits earned during World Wars I and II, and the Korean War.[14]

A type of windfall profits tax on domestic crude oil production was in effect from April 1980 to August 1988. This tax, which was actually an excise tax, not a profits or income tax, was part of a compromise between the Carter Administration and the Congress over the decontrol of crude oil prices. It is discussed and analyzed in detail in CRS Report RL33305.[15] Some have proposed reinstating this tax, although it should be underscored that the current situation giving rise to possible windfall profits — the current reasons for the high price of petroleum products and record profits — is different than the conditions and rationale which existed at the time that tax was imposed.[16]

Reinstating the oil windfall profits tax was again discussed in 1990, when crude oil prices doubled in just two months due to the crisis in the Middle East (Iraq invaded Kuwait on August 2, 1990).[17] More recently, a windfall profits tax has also been discussed as part of the presidential campaign, with Senator Obama reportedly being a proponent of such a tax (in addition to cutting the industry's subsidies and providing a consumer energy credit to compensate for rising prices), and Senator McCain not discussing this option.[18]

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[14] Hakken, John. Excess Profits Tax. *The Encyclopedia of Tax Policy*. Joseph J. Cordes, and Jane Gravelle, eds. The Urban Institute Press, 1999. pp. 108-111.

[15] U.S. Library of Congress. Congressional Research Service. *The Crude Oil Windfall Profits Tax of the 1980: Implications for Current Energy Policy*. CRS Report RL33305, by Salvatore Lazzari. March 9, 2006.

[16] As noted above, the 1980 WPT was imposed as part of compromise to decontrol crude oil prices — a *quid pro quo*. From a control regime level of about $6/barrel before the tax, crude prices were allowed to rise gradually to market levels (as influenced strongly by OPEC), which at that time were about $24/barrel. By contrast, today there are no price controls on crude oil and prices are determined in a generally competitive global crude oil market, one in which the United States is a price taker, and one in which OPEC plays a relatively smaller (but still important) role. Also, more recently crude oil prices have increased for significantly different reasons than was the case in the 1970s. Unlike the 1980s when crude oil prices declined sharply to pre-decontrol levels just after the WPT was imposed (and for most of the life of the tax), crude oil prices since the trough of 1998/1999 have increased fairly steadily and consistently and have surpassed the levels of 1982 in real terms.

[17] From the beginning of July 1990 to August 1990, domestic oil prices (the spot price of West Texas Intermediate) nearly doubled increasing from just over $16 per barrel to nearly $32 per barrel.

[18] The Wall Street Journal. *The Economy: Competing Visions for Fixing Today — and Tomorrow*. August 25, 2008. P. R5, R8. Obama also supports repealing the IRC § 199 manufacturing deduction, which is also allowed for oil and gas companies, raising nearly $10 billion in revenues over 10 years, and another provision to limit the ability of oil and

(continued...)

Windfall Profits Tax Legislation in the 109th Congress

After the enactment of EPACT05 in August 2005, congressional interest in a windfall or excess profits tax on the oil and gas industry intensified. In fact, most of the bills to impose some type of windfall profits tax were introduced in the 109th Congress — there were more than a dozen such bills — after EPACT05 was enacted into law. Many of these bills proposed to use the revenues from the WPT to offset the burden of higher gasoline prices for consumers.[19] There were two types of windfall profits tax bills in the 109th Congress: those that would have imposed an excise tax on windfall profits based on the price of crude oil, and those that would have imposed an income tax on windfall profits based on either the existing tax law's definition of corporate taxable income or excessive rates of return.

Excise Tax Type of WPT. As noted above, the WPT that was in effect from 1980-1988 was not an income tax but an excise tax — it was not a type of tax that most economists would consider a true tax in "windfall gains or income." The tax was imposed on the difference between the market price of oil, which was technically referred to as the removal price, and a statutory 1979 base price that was adjusted quarterly for inflation and state severance taxes. Almost every barrel of domestically produced crude oil — i.e., every barrel of domestic production that was not specifically tax-exempt — was subject to this excise tax.

The excise tax type of WPT was the type proposed in most of the WPT bills in the 109th Congress. These bills would have generally imposed an excise tax equal to 50% of the windfall profits not reinvested in 1) oil/gas exploration and drilling, 2) increased refinery capacity, 3) renewable electricity property, or 4) facilities for producing alcohol fuels or bio-diesel. These bills would have defined a windfall profit as the difference between the market price of oil (at the wellhead) and an inflation-adjusted base price of $40/barrel — in other words, they would have effectively defined a windfall as the difference between the market oil price and $40. S. 1631, H.R. 3752, H.R. 4203, H.R. 4248, H.R. 4449, H.R. 4263, S. 1981, and S. 2103 were of this type. S. 1631 (Dorgan) was offered as an amendment to S. 2020, the Senate's version of tax reconciliation which went to conference, but was ruled out of order.

Income Tax Type of WPT. Some of the WPT proposals in the 109th Congress were of the income tax type, using the existing corporate income tax system

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[18] (...continued)
gas companies to claim foreign tax credits for their overseas operations could raise another $4 billion. According to the Bureau of National Affairs, Inc. *Daily Tax Report*. "Obama Says Tax Plan Offers More Tax Cuts." Pp. GG1, Friday, August 29, 2008.

[19] Some of the bills would have allocated the receipts to offset the cost of supplemental spending bills targeted to aid victims of Hurricanes Katrina and Rita. Others would allocate them to the highway trust fund to compensate for any losses from the proposed commensurate reduction in motor fuels excise taxes to offset the WPT. Several bills would have appropriated the proceeds for the Low-Income Home Energy Assistance Program, which gives grants to poorer households to offset high energy bills and for residential weatherization.

to assess the tax, or defining the tax base in terms of taxable income under the existing corporate income tax.

Typical of the income tax type of WPT were those that would have imposed a 50% tax on the excess of the adjusted taxable income for a taxable year over the average taxable income during the 2000-2004 period. The 50% tax would have applied to crude producers and integrated oil companies with sales in 2005 or 2006 above $100 million. The tax would have been temporary and would apply to petroleum products as well as crude oil. S. 1809 (Schumer) and H.R. 4276 (Larson) in the House were of this type. Senators Schumer and Reed sponsored S. 1809 as an amendment to S. 2020 (S.Amdt. 2635 and S.Amdt. 2626). In both cases, the amendments were ruled out of order.

A variant of the income tax type of WPT is H.R. 3712 (McDermott). This bill would have taxed any profit from the sale of crude oil, natural gas, or products of crude oil and natural gas above a 15% rate of return at 100%. Tax revenues would have been earmarked for a program of gas stamps to help indigent persons offset the burden of recent high gasoline prices, which would be similar to the current federal food stamp program.

Other Types of WPT Proposals. Some WPT proposals are not easily classified. For example, H.R. 2070 (Kucinich), H.R. 3664 (Kanjorski), and H.R. 3544 (DeFazio) would have imposed a graduated tax with the rates — 50%, 75%, or 100% — dependent on the extent to which profits exceed a reasonable level, as determined by a specially created board or commission. These bills differ, however, on how the tax's proceeds would be used.[20] Whether these WPT would have been excise tax based or income tax based, or whether they would have used some other tax base, is unknown since the bills did not provide a definition of either profits or a reasonable profit.

Windfall Profit Tax Legislation in the 110th Congress

WPT proposals have been introduced in the 110th Congress, although there are fewer excise tax based and more income tax based than in the 109th Congress. Also, many of the income tax based proposals have focused on repealing the IRC § 199 deduction for domestic manufacturing activities, which is effectively equivalent to an increase in the existing marginal corporate tax rate — and is not really tax on windfall profits. As discussed in more detail below, the corporate income tax system could be used as an administratively simple way to increase the tax burden on the oil and gas industry, and approximate a WPT without the risks of adverse economic and energy market effects.

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[20] H.R. 3544 (DeFazio) would impose price controls on gasoline, ban drilling in the Arctic National Wildlife Refuge, mandate minimum levels of inventory of crude oil and petroleum products, ban the export of Alaskan oil, and facilitate the draw down of the Strategic Petroleum Reserve. H.R. 2070 (Kucinich) would fund income tax credits for the purchases of fuel-efficient passenger vehicles, and to allow grants for mass transit.

Excise Tax Type of WPT. S. 1238 (Casey) would impose a 50% excise tax on any major integrated oil company based on the difference between the market price of oil and $50 (this $50 would be adjusted annually for inflation). This bill is the only bill to propose an excise type of WPT in the 110th Congress.

Income Tax Type of WPT. On the Senate side two bills introduced by Senator Clinton, S. 701 and S. 2971, would tax half of the excess profits of major integrated oil producers, and oil producers with gross revenues above $100 million per year. Excess profit would be defined as taxable income above 110% of the average taxable incomes over the 2000-2004 period. Thus, these bills would use the existing tax law definition of taxable income, which, as discussed below, not only facilitates tax administration and compliance, but also minimizes economic distortions and adverse, short-run economic effects. S. 2991 and S. 3044 (Reid) take a similar approach to the Clinton bills, but would 1) tax excess profits at a lower rate, 25% instead of 50%, and 2) use 2001-2005 (2002-2006 in S. 3044) as the base period rather than 2000-2004. Also, any increased investment in renewable energy over the same base period would be credited toward the tax and hence, reduce the windfall profit tax liability. S. 3044 (Reid) is the Democratic leadership bill; it was introduced on June 11, 2008.[21]

Other Types of WPT Proposals. H.R. 5800 (Kanjorski) and H.R. 6000 (Kucinich) would tax excess profits above a "reasonable" amount at rates ranging from 50% to 100%. A Reasonable Profits Board would be created to determine the reasonable profit level. The tax base to which this tax would apply appears to be the income tax, but it is not defined.

Analysis of Economic and Policy Issues

Even with rising crude oil and petroleum product prices, and record oil industry profits, not all of those profits or returns constitute a windfall or unearned income — much of that income may be a return to investment and its capital stock, a return on the firm's decision-making and risk-taking. And, indeed, the business income taxes paid to state and local governments, the federal government, and even foreign countries, which are substantial, reflects their share of these profits in the form of taxes. **Table 6** shows the total taxes reported in their financial statements by the major integrated oil companies in 2005, 2006, and 2007. These include income, excise (including motor fuel excise taxes to federal, state, and local governments), and severance taxes (which are primarily state levies). The record profits earned by the five major oil companies generated liability for tax payments that increased by

[21] S. 3044 would also roll back $17 billion in existing oil and gas industry tax breaks over 10 years for the largest oil companies; revenues would be earmarked to expanding renewable energy development. In addition to the tax provisions, S. 3044 would prohibit, and provide penalties for, price gouging by the oil and gas industry, tighten regulation of speculators in offshore oil, and suspend filling of the Strategic Petroleum Reserve.

32% from 2005 through 2007 as shown in **Table 6**. Any windfall profits tax that might be adopted would add to these tax revenues.[22]

Table 6. Tax Payments by the Major Oil Companies, 2005-2007
(billions of dollars)

	2005	2006	2007
ExxonMobil	23.30	27.90	29.86
Shell	17.99	18.31	18.65
BP	9.29	12.31	21.17
Chevron	11.10	14.84	13.48
ConocoPhillips	9.91	12.78	11.38
Total	**71.59**	**86.14**	**94.54**

Source: Company Income Statements, available at [http://www.hoovers.com].

Such taxes, however, do not belie the existence of windfall gains or unearned income, and do not necessarily undermine the case for a WPT. A well designed and structured WPT tax, however, would tax only the true windfall component of oil industry incomes. Moreover, such a tax would be simple to administer and comply with, and would avoid or minimize any adverse economic and energy market effects. As the discussion below suggests, while in theory the concept of a windfall profit seems simple and intuitive, in practice it can be difficult to measure accurately and so the actual implementation of a WPT involves a compromise over differing fiscal policy objectives: 1) administerability — collecting the excess revenues (or windfall gains) in the least costly manner in terms of tax administration and compliance, 2) economic efficiency — devising and structuring the tax in a way that minimizes economic distortions, including adverse output and price effects, and adverse impacts on petroleum imports, energy independence, and energy security.

The remaining sections of this report discuss some of the more important economic issues surrounding proposed legislation, and draw relevant policy implications. The final section discusses alternative policy options.

Defining and Measuring Windfall Gains

The most vexing problem in designing a WPT is how to define a true windfall, i.e., the tax base. In theory, there is a difference, even if a subtle difference, between a windfall gain, excess profit, and an unearned gain. A windfall gain applies to

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[22] According to the U.S. Department of the Interior, the domestic oil industry in the United States also pays billions in royalties, which are not taxes but factor payments, the return to landowners on their mineral assets. For FY2007, total federal royalties on oil and gas (including natural gas liquids) were $9.4 billion. See the Minerals Management Services website at [http://www.mrm.mms.gov].

income or wealth that is unexpected, a gain which arrives fortuitously, possibly due to factors outside of the control of the institution in question. This can be distinguished from excess profits, which might be considered to be more subjective, and are based on defining an acceptable profit, and attributing everything above that level as excessive. This difference might be illustrated with a hypothetical example: a firm might be so efficient that its above-average profitability (or returns) might be considered excessive, but not a windfall. However, if its production waste, which formerly was costly to dispose of, became valuable, that gain might be considered a windfall.

Finally, one might differentiate both a windfall profit and an excess profit from an economic rent, a technical term for the return to a fixed factor of production or resource. For such resources that are in fixed supply, economic analysis suggests that earned profits are not necessary for the services of that factor to be available to the market.

The record profits reported by the oil and gas industry have characteristics of both windfall gains, excess profits, and even economic rents, although they are more in the nature of "quasi-rents" than pure economic rents because some industry investment, effort, and risk is required for production: oil supply is not perfectly inelastic. Thus, for purposes of taxing this income — from the perspective of merely raising revenues — it matters little whether the tax is an excise tax or income tax type, or whether it is based on industry rates of returns compared to rates of return in other industries (manufacturing, for example), or in the general economy. Since the profits are price-driven, and since there is little or no output or investment effect, either the excise tax or income tax or rate of return type could be used to collect the windfall.

Rather, the critical difference in the type of WPT tax to implement is in the firm's economic response to the tax, and in the cost of administration and compliance costs. The next two sections of this report examine the output and price effects of the two different types of WPT. It also examines the effects on the demand for oil imports, and therefore energy independence, and energy security. Finally, this section examines a variety of other tax options for increasing the tax burden on the oil and gas industry, options that have been offered as alternatives to the WPT. In general the conclusions of this analysis are that an excise tax is non-neutral and could have adverse economic effects, particularly on the level of dependence on foreign oil, while the income tax approach is relatively neutral in the *short run*, thus minimizing economic distortions and other adverse economic effects.

The Non-neutral Economic Effects of the Excise Tax Type of WPT

As discussed in more detail below, an excise tax on domestically produced crude oil may only approximate a windfall profit tax, and may have certain adverse energy market and economic effects. In other words, depending on how a WPT were structured, an excise tax type of WPT — for instance, by reinstating the WPT of the 1980s — might make the United States more dependent upon foreign oil, which in turn might have implications for energy security.

Output Effects. Economic theory suggests that a WPT in the form of an excise tax — e.g., H.R. 3752 and S. 1631 in the 109th Congress; S. 1238 in the 110th Congress — could reduce domestic oil production.

In economic terms, oil producers would likely view the tax as an increase in the marginal, or incremental, cost of domestic oil production — the marginal cost of producing every barrel of taxable crude oil would be higher by the amount of the excise tax. An increase in the marginal cost of production might be viewed as an incentive to produce less oil. However, this effect is likely to be mitigated in the U.S. oil market by other factors. The theoretical analysis assumes that the difference between price and marginal cost is relatively small, implying that the imposition of a tax would reduce profits to, or below, the competitive level. In the current oil market, oil prices are typically far above the marginal cost of production, implying that even after paying a tax, profitability could remain high, continuing to provide an incentive for production. The economic analysis also assumes that some cheaper alternative source of oil is available to substitute for taxed domestic production. Firms are unlikely to pay the market price for oil in the international oil market instead of using domestic production. If they did this, they would lose the difference between the price and cost of domestic oil, substituting foreign oil, for which price is effectively equivalent to marginal cost. Finally, marginal production adjustments are unlikely to be made to existing oil wells. Once an oil well goes into production, the maximum sustainable flow rate is likely to simultaneously be the maximum economic flow rate, allowing for oil field management to be based on physical factors related to output.

Oil Imports and Energy Independence. If the domestic supply of oil were reduced in response to an excise tax on domestically produced oil, the demand for imported oil and petroleum products would likely increase, unless some other policy would concomitantly reduce the demand for petroleum to offset a tax-induced reduced supply. This is because oil imports to the United States are a residual, adjusting to reflect the difference between aggregate demand for oil and aggregate domestic oil supply.

Price Effects. One of the concerns — and one of the arguments made by opponents of a WPT — is that such a tax would raise prices: a WPT on crude oil would raise the price of crude oil, which would then be passed on to consumers in the form of higher petroleum product prices — higher prices of gasoline, diesel, jet fuel, and other products. If true, then this might defeat one of the purposes of imposing such a tax: to relieve consumers (both personal and business consumers such as truck drivers) from the burden that recent high gasoline and diesel price have had on them.

As noted, an excise tax only on oil produced domestically in the United States would increase marginal or incremental production costs, and, in theory, a profit maximizing firm would respond to this type of tax by reducing output and attempting to raise prices to offset the higher marginal production costs. However, in the case of domestic crude oil, the higher marginal cost cannot be shifted forward as a higher

oil price, because oil is priced in the international (world) oil market).[23] Oil producers would not be able to shift the tax forward as a higher oil selling price because the first purchaser (generally, the refiner) would merely substitute imported crude, which would be tax-exempt. Instead, this type of WPT would reduce the net selling price paid to producers. As noted earlier, the first purchaser would subtract the tax from the price paid to the producer (supplier) — the producer's net selling price of each barrel of oil would be less by the amount of the WPT.

The Neutrality of the Corporate Income Tax Type of WPT

Output Effects. From an economic perspective, the income tax based WPT — such as those that use the existing corporate tax system to define excess or windfall taxable income — would be relatively neutral in the short run — it would have no (or few) output, or price effects and other economic effects. The reason for this is that a firm maximizes profit at the point at which market prices are equal to marginal production costs, and neither are affected in the short run by an increase in the corporate tax burden — the profit maximizing level of output and price are unaffected by the tax. Thus, to the extent that a surtax on the corporate income of crude oil producers on their upstream operations could approximate such a tax, this would not raise crude oil prices and would not tend to increase petroleum imports *in the short run*.

In the long run, however, all taxes (or almost all taxes) distort resource allocation, and even a corporate profit tax (either of the pure type or the surtax on the existing rates) would raise average long-term production costs, reduce the rate of return and reduce the flow of capital into the industry relative to other industries, and move resources away from the corporate form of business organization. All these effects could adversely affect domestic production, possibly resulting in increased petroleum imports.

Oil Imports and Energy Independence. Because the income tax type of WPT does not create incentives to reduce domestic production in the short run, there is no increase in the demand for imports under such a tax in the short run, although it could if the tax were still in effect in the long run.

Price Effects. From an economic perspective, that is to say, in theory, increasing marginal tax rates on corporate income would have no (or few) price effects. The reason is as before: a firm maximizes profit at the point at which market prices are equal to marginal production costs, and neither are affected by an increase in marginal tax rates — the profit maximizing level of price is unaffected by such a tax.

Alternative Policy Options

As mentioned above, should Congress decide to tax oil industry surpluses, there would be several alternative policy options to increase taxes on the domestic oil and gas industry, including eliminating the industry's several targeted tax subsidies,

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[23] There may be some small price effects if the export supply curve is not perfectly elastic.

reducing tax benefits provided through the general or non-targeted provisions of the tax code, or even eliminating the tax incentives enacted under EPACT05. These options are discussed in a separate CRS report.[24] Rather, the remaining sections of this report address alternatives that are really variations on the two WPT options discussed before.

Rescinding the § 199 Deduction. One option that has been proposed frequently in congressional bills is the repeal of, or reduction in, the IRC § 199 deduction for domestic manufacturing activities. This option does not actually attempt to measure or tax windfall profits, but uses the existing corporate income tax system to effectively increase the marginal corporate tax rate on domestic oil and gas producers, targeting primarily the major integrated oil companies.[25]

Enacted in 2004 as an export tax incentive, this provision allows a deduction, as a business expense, for a specified percentage of the qualified production activity's income (or profit) subject to a limit of 50% of the wages paid that are allocatable to the domestic production during the taxable year. The deduction was 3% of income for 2006, is currently 6%, and is scheduled to increase to 9% when fully phased in by 2010. For the domestic oil and gas industry, which qualifies for this deduction (i.e., it is not excluded from claiming it) the deduction applies to oil and gas or any primary product thereof, provided that such product was "manufactured, produced, or extracted in whole or in significant part in the United States." Note that extraction is considered to be manufacturing for purposes of this deduction, which means that domestic firms in the business of extracting oil and gas from underground reservoirs or deposits qualify for the deduction. This deduction was enacted under the American Jobs Creation Act of 2004 (P.L. 108-357, also known as the "JOBS" bill). It was originally a substitute for repeal of the export tax benefits under the extra-territorial income tax exclusion, which was ruled to be in violation of trade laws.[26]

Repealing, or cutting back this deduction would be effectively equivalent to an increase in the marginal income tax rate, and as noted earlier a change in the corporate tax burden in the short run is relatively neutral. For example, at the top marginal corporate tax rate of 35%, which typically applies to large corporations such as major oil and gas producers and refiners, the current deduction of 6% is equivalent to a marginal corporate income tax rate of 32.9% (35% x 0.94) rather than 35%.[27] The proposed elimination of this deduction would be, thus, equivalent to an increase

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[24] See CRS Report RL33763, *Oil and Gas Taxes and Subsidies: Current Status and Analysis*, by Salvatore Lazzari.

[25] Repealing this deduction has been part of almost every major energy tax bill in the Congress over the last two years. Section 199 repeal is also part of the so-called "Gang of 16" draft energy bill (no number yet) which would also open up much of the Outer Continental Shelf to oil and gas production, and restrict speculation in the oil commodities (futures) markets.

[26] CRS Report RL32652, *The 2004 Corporate Tax and FSC/ETI Bill: The American Jobs Creation Act of 2004*, by David L. Brumbaugh.

[27] Corporations are currently taxed at 15% of the first $50,000 of taxable income, 25% of the taxable income from $50,001 to $75,000, 34% of the taxable income from $75,001 to $10 million, and 35% of taxable income above $10 million.

in the marginal tax rate from 32.9% to 35% for those major oil companies to which this would apply. All other large corporations would continue to face a top marginal tax rate of 32.9%, with the exception of non-manufacturing enterprises (services, for example), which do not qualify for the § 199 deduction. Thus, as noted, this option does not attempt to measure and tax the oil industry's windfall profits; it is just a way of using the existing corporate income tax system to increase the tax burden on the oil industry, and recoup some of the windfall or excess profits in the form of corporate income taxes.[28]

As before, eliminating the deduction — that is to say, raising the corporate tax rate — would increase total (or average) business costs and therefore reduce profitability among the major oil and gas producers. As long as marginal production costs are unaffected, there would be no price effects *in the short run*. Similarly, the demand for imports is likely to remain the same in the short-run. Thus, this type of corporate income tax increase would arguably be an administratively simple and economically effective way to capture at least some of the oil industry's windfalls in the short run. However, at a current deduction of 6%, and a marginal corporate tax rate of 35%, only a small portion of the industry's likely windfalls would likely to be captured under this option.

The market price of crude oil and natural gas, or even of refined petroleum products, such as gasoline, would not be expected to increase very much, if at all, by such a change in the short run. In general, also, the income tax increases are not expected to have real output effects in the short run, although they could cause resources to flow to other industries in the long run as long as these other industries are allowed the manufacturing deduction, which is equivalent to a lower marginal tax rate.

An Income Type WPT Tax and § 199 Repeal. Some WPT proposals combine the WPT, with a repeal or reduction in the § 199 manufacturing activities deduction. This effectively uses two instruments to raise the corporate tax rate on domestic oil and gas producers, which, as noted before, would be relatively neutral in terms of its price, output, and import effects. One bill that takes this approach is S. 3044, which would rescind the IRC § 199 deduction for major integrated oil companies, and assess a 25% tax on the difference between profits in any one year and 110% of the average of profits over the 2002-2006 period.[29] This bill follows many of the earlier bills in that it attempts to recoup for the federal taxpayer some of the windfall or "excess" profits reported by the oil and gas industry as a result of unprecedented high petroleum prices.

A Tax on Imported and Domestically Produced Crude Oil. If, instead, an excise tax were to be imposed broadly on both imported as well as domestically produced oil (as proposed in the early 1980s by the Reagan Administration), this tax

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[28] The proposed repeal or cutback in the § 199 deduction could also be a way of funding other provisions in the bills.

[29] S. 3044 also restricts the ability of major oil and gas companies to claim tax credits for taxes and other payments to foreign governments against the U.S. tax on foreign source income, which also is a way of increasing the corporate tax burden.

would produce upward price effects — the price of crude oil in the United States would tend to be higher than under the WPT on domestic oil alone. This is because the tax would be imposed on imports, which are the marginal source of oil supplies and therefore the benchmark for crude oil prices. The effect on domestic production and the level of imports — dependence on foreign imports — would depend on the size of the tax and the price elasticities of domestic supply and import demand.

An Excise WPT and Gas Tax Suspension. An excise tax holiday — suspension of the 18.4¢/gallon tax on gasoline — combined with an equal revenue WPT on oil would be completely counterbalanced or offsetting. Eliminating the gasoline tax might cause refiners to reduce prices over time by the amount of the tax, depending on the state of the energy market at the time of suspension, (or somewhat less depending on tax incidence, which depends on the ratio of price elasticities of the demand and supply schedules), but the excise-tax based WPT on all crude oil (i.e., one imposed on both imports and domestic production) would be shifted as a higher price of crude oil bought by refiners, thus offsetting the decline in product prices.[30]

Possible Revenue Effects

A WPT on crude oil could generate sizeable revenues depending on the tax rate and the tax base, i.e., whether it was excise tax based or income tax based, and depending on crude oil prices at the time the tax were imposed. This section of the report does not provide revenue estimates, because CRS neither has the data nor the estimating models to do so.

The excise tax based WPT probably has the greatest revenue potential merely because of the high recent level of crude oil prices, and because the tax base is not adjusted for operating costs (operating costs are not deducted from the tax base) as in the case of the income-tax based WPT. To illustrate, S. 1238 (Casey) would tax any major integrated producer on the difference between market price and $50/barrel at a 50% rate. If oil prices remain over $100 per barrel, this tax could generate substantial revenues.

The income tax type of WPT generally has a smaller revenue potential, again because, 1) taxable income is used as the tax base, which is generally much smaller than book income (which is the net income measure reported in **Table 4**). Also, the income tax based proposal typically uses the average of taxable income over a lagged five-year period. Thus, in a period of generally rising prices, the base tends to progressively decline.

Finally, there are revenue estimates related to repeal of the IRC § 199 deduction. These have been estimated several time in recent years by the Joint Committee on

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[30] Eliminating the gasoline tax would deny the Highway Trust Fund of its principal source of revenue unless some adjustment were made. See CRS Report RL30497, *Suspending the Gas Tax: Analysis of S. 2285*, by Salvatore Lazzari. and CRS Report RL34475, *Transportation Fuel Taxes: Impacts of a Repeal or Moratorium*, by John W. Fischer and Robert Pirog.

Taxation for several different congressional proposals. The figures reported in **Table 7** are the most recent available, and show that over 10 years, nearly $10 billion in additional revenue could be collected from repealing the § 199 deduction for major integrated oil producers. It should be noted that the figures in **Table 7** would likely change if they were re-estimated using more current assumption about crude oil prices, the state of the oil industry, the condition of the macro-economy, and other economic variables.

Table 7. Estimated Revenue Effects of Repealing the § 199 Deduction for All Oil and Gas Industry, and for Major Integrated Oil and Gas Producers

(billions of dollars)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-2012	2008-2017
Revenue Effect	0.262	0.605	0.776	0.950	1.022	1.098	1.180	1.269	1.364	1.466	3.615	9.992

Source: U.S. Congress. Joint Committee on Taxation. Estimated Budget Effects of the Revenue Provisions Contained in Titles I. And XV. Of H.R. 6, The Clean Renewable Energy and Conservation Tax Act of 2007, as Passed by the House of Representatives on December 6, 2007. JCX-112-07, December 12, 2007.