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The Windfall Profit Tax: Origins, Development Implications

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THE WINDFALL PROFIT TAX: ORIGINS, DEVELOPMENT, IMPLICATIONS†

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Table of Contents

I. Origins: Production and Price Controls	635
A. Oil Production	635
1. Geophysical and Economic Characteristics	635
2. Institutions	636
a. Majors and Independents	636
b. State Conservation and "Stripper" Oil	637
3. Imported Oil	638
B. Price Controls on Crude Oil	639
1. Initial Program	639
2. Stripper Wells and Price Controls	642
3. Price Controls on Crude Oil, 1976-1979	642
4. Implementation of EPCA Amendments	643
a. The Price of Alaskan Oil	643
b. Modification of Base Production Control Levels	644
c. Modification of Regulations to Encourage Enhanced Recovery	645
5. Detriments of Price Controls	647
6. The November, 1978 Notice	650
a. Marginal Oil	651
b. Updating Base Production Control Levels	651
c. Decontrol Some Production from All Wells	651
d. Raise the Price of Lower Tier Crude Oil	652
II. Decontrol and the Windfall Profit Tax	652
A. The Administration's Proposal	652

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1. Decontrol	653
2. The Windfall Profit Tax	659
a. General Structure	660
b. Tier 1	661
c. Tier 2	663
d. Tier 3	664
e. Other Provisions	667
B. The Ways and Means Committee Bill	667
1. In General	667
2. General Structure	669
3. Tier 1	671
4. Tier 2	671
5. Tier 3	672
a. Stripper Oil	672
b. Incremental Tertiary Oil	672
c. Newly Discovered Oil	674
d. Alaskan Oil	675
6. Other Provisions	676
a. Public Education Exemption	676
b. Rejected Amendments	676
C. The House Bill	677
D. The Finance Committee Bill	678
1. Structure	679
2. Tier 1	680
3. Tier 2	680
4. Tier 3	681
5. The Exemptions	681
a. Newly Discovered Oil	681
b. Incremental Tertiary Oil	682
c. Heavy Oil	683
d. Stripper Oil	684
e. State and Local Governments	684
f. Indian Tribes	685
g. Medical and Educational Charities	685
6. Other Provisions	685
a. Percentage Depletion	685
b. Phase-Out of Tax	685
7. Revenue Effects	686
E. The Senate Bill	686
F. The Conference Agreement	690
G. Final Passage and Enactment	698
III. Conclusions	699

INTRODUCTION

Enactment of the windfall profit tax on April 2, 1980, represented the climax of an intense, seven-year debate on national oil policy. The focus of the debate was the distribution of increased domestic oil production income attributable to the exercise of oligopolistic pricing power by the members of the Organization of Petroleum Exporting Countries (OPEC).¹ Initially, domestic oil producers were denied a portion of such increased income by a system of price controls that required domestic crude oil to be sold at prices substantially below world prices. The controls program, however, created economic distortions, particularly, excessive consumption of petroleum and unnecessarily high dependence on imported oil.² These distortions led to four attempts between 1973 and 1979 to replace or supplement price controls with a tax that would prevent the full transfer of income from consumers to producers while, at the same time, encouraging conservation by bringing domestic oil prices to world levels. The first three attempts were unsuccessful.³ The fourth resulted in phased decontrol of domestic crude oil prices and the windfall profit tax.⁴ Con-

¹ Certain initials are used throughout the article. Each is set out below, along with its full meaning and the location in the article where first used and defined.

<i>Initial</i>	<i>Full Meaning</i>	<i>First Used At</i>
ABPCL	Adjusted base production control level	note 69
ANS oil	Alaska North Slope oil	note 61
BPCL	Base production control level	note 38
DOE	Department of Energy	notes 34-35
ECPA	Energy Conservation and Production Act	note 59
EPAA	Emergency Petroleum Allocation Act	note 37
EPCA	Energy Policy and Conservation Act	note 54
OPEC	Organization of Petroleum Exporting Countries	note 1

² See, e.g., EXECUTIVE OFFICE OF THE PRESIDENT, THE NATIONAL ENERGY PLAN 51 (Apr. 29, 1977) [hereinafter cited as NATIONAL ENERGY PLAN]; § I.B.5. *infra*.

³ On December 19, 1973, the Nixon Administration proposed a windfall profits tax, based upon the difference between the sales price and a base price. On May 4, 1974, the Ways and Means Committee reported a bill which included the windfall profits tax. The bill was never taken up on the House floor. H.R. 93-14462, 93d Cong., 2d Sess., later reported as Title I of H.R. 93-17488, 93d Cong., 2d Sess. On January 21, 1975, the Ford Administration also proposed a windfall profits tax. The tax was not included in a subsequently reported Ways and Means Committee bill, but was agreed to by the Finance Committee, contingent on decontrol. H.R. 94-6860, 94th Cong., 1st Sess. (1975). On April 29, 1977, the Carter Administration proposed a crude oil equalization tax as part of its first National Energy Plan. NATIONAL ENERGY PLAN, *supra* note 2, at 51-52; part D of Title II of H.R. 95-6831, 95th Cong., 1st Sess. (1977). The crude oil equalization tax was an excise tax levied on first purchasers of crude oil equal to the difference between the world market price and the regulated price. The crude oil equalization tax passed the House of Representatives, Part III of Title II of H.R. 95-8444, 95th Cong., 1st Sess. (1977), but was not adopted by the Senate. The conference agreement on the tax provisions of National Energy Plan I did not adopt the crude oil equalization tax. S. REP. NO. 95-1324, 95th Cong., 2d Sess. 55 (1978).

⁴ Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 *et seq.* (Apr. 2, 1980).

sequently, the price of crude oil produced in the United States is to be established by the world market, but a significant portion of the resultant increase in revenue will flow, through the mechanism of the windfall profit tax, to the federal government rather than to the producers of crude oil.

The windfall profit tax is, in principle, a modified *ad valorem* excise tax. The tax base, labeled the "windfall profit," is determined by subtracting a base price and an adjustment for state severance taxes from the price for which a barrel of crude oil is sold.⁵ In no event, however, may the windfall profit per barrel exceed 90 percent of the net income attributable to that barrel.⁶ The amount of the tax is equal to the windfall profit multiplied by the applicable tax rate.⁷ Domestic crude oil is either exempted entirely from the tax, or assigned to one of three categories, or "tiers."⁸ With each tier is associated a tax rate depending on the status of the producer,⁹ a set of rules for determining the base price,¹⁰ and a method for adjusting the base price for inflation.¹¹

The windfall profit tax is extraordinarily complex, replete with questionable provisions, and likely to lead to years of controversy. Despite these obvious deficiencies, the windfall profit tax may make an important contribution to domestic energy policy by making possible the elimination of one of the most counterproductive of domestic energy programs, the regulation of oil prices. The windfall profit tax is, therefore, properly viewed as a stage in the evolution of U.S. oil policy. Consequently, in order to explain the role of the tax, the article begins with background on oil production and oil price controls.

The first section of this article will focus on the geophysical and economic characteristics of production and the nature of the oil industry, and will outline important regulations prior to price controls and point out the role of imports. The article will then review the history of oil price controls, beginning with the wage and price freeze of 1971, and concluding with the decontrol programs of Presidents Carter and Reagan. In this section, price control rules will be discussed and criticized.¹² Next, the legislative development of the tax will be described with a view towards explaining why the various substantive provisions were adopted,¹³ but without extensive criticism of those provisions. Thus, this section is neither an analytical essay nor a guide to how the tax works. The final section evaluates the tax in the context of U.S. energy policy. It is con-

⁵ I.R.C. § 4988(a).

⁶ I.R.C. § 4988(b).

⁷ I.R.C. § 4987(a).

⁸ I.R.C. §§ 4986(a); 4991(a); 4991(b).

⁹ I.R.C. § 4987(b).

¹⁰ I.R.C. §§ 4989(c); 4989(d).

¹¹ I.R.C. § 4989(b).

¹² The extended discussion of price controls is intended to serve two purposes: (1) it helps explain the choice of phased decontrol as a policy, and (2) because many of the price control concepts and rules survive today in substantive provisions of the windfall profit tax, it provides necessary background for the tax provisions.

¹³ The administrative and procedural provisions of the windfall profit tax are not discussed herein.

cluded that the windfall profit tax, despite all its deficiencies, may well represent an important step forward to a more rational domestic energy policy.

I. ORIGINS: PRODUCTION AND PRICE CONTROLS

A. Oil Production

To provide background both for price controls and the windfall profit tax, certain general aspects of the domestic oil industry are discussed here. This section begins with some of the basic physical and economic characteristics of oil production, and a brief description of the division of the U.S. oil industry into major and independent companies. Next, state regulation of oil production through conservation and prorationing is considered, with particular emphasis on the concept of the "stripper" well. Finally, the vital and changing role of oil imports in the domestic petroleum market is summarized.

1. Geophysical and Economic Characteristics

Subsurface deposits of oil generally occur in separate natural reservoirs, each under a single natural pressure system physically separated from other reservoirs,¹⁴ such that production in any part of the reservoir affects pressure throughout the reservoir.¹⁵ The terms "field," "property," "interest," "lease," "tract," etc., are commonly used to describe surface boundaries. It is possible for a single well and, perforce, wells from any surface area, however delineated, to tap more than one reservoir, and for a single reservoir to be tapped from more than one property.

The process of oil production involves the exploration for and development of reservoirs. Once an exploratory well has discovered a reservoir, development wells are drilled for the purpose of extracting the oil. Initially, oil flows from a well because the well creates a point of low pressure in a reservoir through which the fluids attempt to escape.¹⁶ Over time, however, pressure in the reservoir decreases as fluids are removed from it. The decline of reservoir pressure with depletion largely accounts for the decline in producing capacity of oil wells.¹⁷

The rate of production from a reservoir is maintainable only by additional investment, either by pressure maintenance processes, such as water injection, steam injection and other, more exotic enhanced recovery techniques, or by drilling more wells.¹⁸ All of these activities involve increased costs. Thus, the

¹⁴ F. LAHEE, STATISTICS OF EXPLORATORY DRILLING IN THE UNITED STATES, 1945-1960 132 (1962), cited in M. ADELMAN, THE WORLD PETROLEUM MARKET 30 (1972) [hereinafter cited as ADELMAN].

¹⁵ *Id.*

¹⁶ S. McDONALD, PETROLEUM CONSERVATION IN THE UNITED STATES: AN ECONOMIC ANALYSIS 15 (1971) [hereinafter cited as McDONALD].

¹⁷ McDONALD, *supra* note 16, at 16.

¹⁸ ADELMAN, *supra* note 14, at 30.

costs of production of a given quantity of oil from a reservoir generally increase as the reservoir is depleted. The economic debates over price controls and related taxation of oil frequently have ignored the increasing costs of maintaining the rate of production. The usual assertion has been that production from a reservoir that began when oil prices were at a certain level can continue indefinitely, if the amount received for the oil remains at the initial level. Thus, many have argued that actions that would allow oil initially produced at low cost to be sold at higher prices would only confer an "economic rent" upon the producer.¹⁹ As a consequence of this attitude, the control program, and later, the windfall profit tax, have been designed to prevent producers from capturing such rents.²⁰ Because they ignore increasing costs, however, such programs may result in discouraging or delaying the more expensive secondary and tertiary recovery programs.²¹

2. Institutions

a. *Majors and Independents*

Oil is usually marketed in the field at prices posted by the principal buyers, generally, refining companies. While the large, integrated companies dominate refining, they do not dominate domestic oil production. In 1977, the eight largest oil companies produced roughly 50 percent of all domestic crude oil; the twenty-four largest companies produced roughly 75 percent.²² The remaining 25 percent was produced by more than 5,400 other firms and individuals. These other firms are commonly referred to as "independent" producers. The term "independent" came into use because these firms usually

¹⁹ Typically, economists speak of conferring a rent or quasi-rent on a factor of production, the supply of which is temporarily or permanently fixed. In such cases, shifts in demand for the factor of production do not induce changes in supply but only in the price of the factor in question. On those occasions where the demand increases, an increase in the price of the factor results. "Rent" has been defined as "a payment above the minimum amount necessary to attract this amount of the input." E. MANSFIELD, *MICROECONOMICS, THEORY AND APPLICATIONS* 370-371 (1975). Mansfield notes,

Why is it important to know whether or not a certain payment for inputs is a rent? Because a reduction of the payment will not influence the availability and the use of the inputs if the payment is a rent; whereas, if it is not a rent, a reduction of the payment is likely to change the allocation of resources.

The concept of rents has been extended to exhaustible resources, such as oil and gas. Hotelling, *The Economics of Exhaustible Resources*, April 1931, *J. POL. ECON.* 137. Rents from the production of depletable resources decrease over time because costs of production increase as reserves are depleted. This characteristic of rents suggests that a tax based upon the existence of rents should decrease accordingly. See notes 166, 313 *infra*.

²⁰ Price controls and the windfall profit tax were also designed to provide incentives for certain production, such as the incremental production from tertiary projects. See text at notes 73-88 (price controls) and 363-69 (tax) *infra*. The major emphasis, however, has been on limiting producer income.

²¹ See § I.B.5. (effect of controls) and notes 166 and 313 (effect of tax) *infra*.

²² BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, *ANNUAL SURVEY OF OIL AND GAS* 1977 22-23 (1979).

have little or no vertical integration.²³ This meaning has carried over into the federal income tax laws. Since 1975, only independent producers have been allowed percentage depletion. For tax purposes, "independent" producers are taxpayers who do not, beyond certain threshold levels, refine crude oil or engage in retail sales of oil or natural gas.²⁴

b. State Conservation and "Stripper" Oil

State conservation programs were initially established in the mid-1920's and 1930's to assure that oil reservoirs were developed in an optimal fashion.²⁵ Later, these programs exerted an important influence on the development of price controls and the windfall profit tax. The objectives of the conservation programs were to assure that reservoirs were utilized at maximum efficient rates and that competition between two or more producers tapping the same reservoir did not result in excessive rates of production which would lead to damage to the reservoirs and prevent producers from recovering the maximum amount of oil from the reservoir. State conservation programs operated by means of regulations pertaining to gas flaring, well spacing, maximum rates of production, and occasionally, compulsory unitization.²⁶

During the 1930's, state conservation activities took on another, economically more questionable, role — that of market demand restrictions. Whereas maximum efficient rate restrictions had been imposed to prevent rates of production that significantly reduced ultimate recovery, market demand restrictions were adopted in order to maintain and stabilize prices. Under this program, state regulatory commissions sought to determine the quantity of oil "expected" to be demanded per period in the state or sub-area of the state. If this expected market demand was less than the basic volume of production allowed by the state commission, the state would further limit the production of oil to a fixed percentage of each well's normal production.²⁷ The limitation process was referred to as "prorating."

Not all wells were necessarily subject to prorating, however. Wells that had a low production rate usually were exempt. The exact definition of an exempt well differed from state to state.²⁸ In Texas they were referred to as "marginal wells" and the volume limitations depended on production at various depths.²⁹ In many other states, the exempt category was known as

²³ A. COPP, REGULATING COMPETITION IN OIL: GOVERNMENT INTERVENTION IN THE U.S. REFINING INDUSTRY 1948-1975 3 (1976).

²⁴ I.R.C. § 613A.

²⁵ State conservation programs do not refer to reducing consumption, as most conservation programs do today.

²⁶ MCDONALD, *supra* note 16, at 47.

²⁷ *Id.*

²⁸ W. LOVEJOY AND P. HOMAR, ECONOMIC ASPECTS OF OIL CONSERVATION 154 (1967) [hereinafter cited as LOVEJOY AND HOMAR].

²⁹ For wells from 0 to 2,000 feet deep the maximum allowable rate of production was 10 barrels per day. For wells from 2,000 to 4,000 feet deep the limit was 20 barrels per day, while for

"stripper wells." In Kansas every well was allowed to produce up to 25 barrels per day without becoming subject to prorationing, while in Oklahoma the maximum was equal to the lowest allowable rate for any allocated well, which had been about eight to nine barrels per day. In Louisiana the rate of production was not restricted if the well was "incapable of producing the current allowable at any depth bracket."³⁰ These various prorationing schemes thus represented the first means by which domestic oil prices were directly influenced by government intervention. They remained a major economic control in the oil industry until the 1970's, when increasing demand and escalating import prices eliminated the purported need for prorationing.

3. Imported Oil

The role of imported oil in the domestic petroleum market has changed radically during the post-World War II period. Until 1973, for the stated purpose of insuring a stable, healthy domestic petroleum industry, the United States limited the volume of imports of crude oil and oil products by a mandatory import quota program. During the 14-year history of the import quota, prices of crude oil produced in the United States exceeded the prices which prevailed on world markets.³¹

By the spring of 1973, however, as the price of imported oil surpassed the price of domestically produced crude, President Nixon lifted the quota on the importation of oil. These events marked a fundamental change in domestic crude oil policy. Prior to 1973, market demand prorationing of U.S. production was required to maintain stable crude prices, leaving the United States with surplus crude production capacity. Thereafter, production of crude oil in the United States has continuously been at full capacity.³²

Nineteen seventy-three also marked the point at which the determination of the world price for oil shifted from the United States to the petroleum exporting countries. Imported oil prices caught up with and then surpassed U.S. prices.³³ After 1973, changes in prices of U.S. crude oil not subject to price controls have followed changes in world crude prices. This characteristic of the

wells from 4,000 to 6,000 feet deep the limit was 25 barrels per day and for wells from 6,000 to 8,000 feet deep the limit was 30 barrels per day. Wells over 8,000 feet deep were allowed to produce up to 35 barrels per day and still qualify for exemption. See TEX. RES. CODE ANN. tit. 3, § 85.122 (Vernon).

³⁰ LOVEJOY AND HOMAR, *supra* note 28, at 188.

³¹ D. BOHI AND M. RUSSELL, *LIMITING OIL IMPORTS, AN ECONOMIC HISTORY AND ANALYSIS* 211 (1978) [hereinafter cited as BOHI AND RUSSELL].

³² The history of U.S. oil imports and the role of the oil import quota may be found in BOHI AND RUSSELL, *supra* note 31.

³³ Owens, *History of Petroleum Price Controls*, in *HISTORICAL WORKING PAPERS ON THE ECONOMIC STABILIZATION PROGRAM* 1265 (A. Munroe, H. Peret and J. Brock eds. 1974) [hereinafter cited as Owens]. Owens was the deputy director of the Cost of Living Council responsible for the oil price control program. See text at note 36 *infra*.

oil market had important ramifications for determining the burden of the windfall profit tax.³⁴

B. Price Controls on Crude Oil

Oil price controls originated as part of a general wage and price freeze, but continued after the general freeze ended, for a total of almost 10 years. Described below are the initial oil price control program and its subsequent development through numerous statutory and regulatory revisions. The major deficiencies of price controls are discussed, as are the Department of Energy's (DOE) proposals addressing those problems.

1. Initial Program

Federal price controls were first imposed on crude oil as part of the August 15, 1971, wage and price freeze imposed by President Nixon under the Economic Stabilization Act of 1970.³⁵ Oil was subsequently singled out for special treatment in the Phase IV price control program introduced in August, 1973, by the Cost of Living Council.³⁶ The Emergency Petroleum Allocation Act (EPAA),³⁷ adopted in November, 1973, replaced the Economic Stabilization Act as the statutory authority for crude oil price regulations. The Cost of Living Council's authority over crude oil price controls was replaced initially by the Federal Energy Office, then by the Federal Energy Administration (FEA), and, finally, by the Economic Regulatory Administration of the Department of Energy.

Under Phase IV, oil was divided into two tiers: "old" oil and "new" oil. The distinction between old oil and new oil was determined by the "base production control level" (BPCL) of the property.³⁸ The BPCL for a particular month was, in general, the volume of oil produced from the property during

³⁴ See text at notes 124, 175 *infra*.

³⁵ Economic Stabilization Act of 1970, Pub. L. No. 91-379, 84 Stat. 796 (1970).

³⁶ 6 C.F.R. part 150, subpart L, 38 Fed. Reg. 22536 (Aug. 22, 1973). During Phases I, II, and III of wage and price controls, covering the period from August 15, 1971 to August 12, 1973, oil prices were controlled generally in concert with price controls imposed throughout the economy. Under Phase IV, however, significant changes in the price control rules were adopted specifically for oil prices. The framework established by the Phase IV oil price controls would be continued in subsequent oil price regulations. Consequently, this detailed analysis of oil price controls begins with Phase IV. For a discussion of Phases I, II, and III, as applied to the oil industry, see BOHI AND RUSSELL, *supra* note 31, at 208-21.

³⁷ Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627 (1973).

³⁸ The term "property" is fundamental to the price control regulations since other important regulatory terms are defined with respect to the production characteristics of a "property." See "BPCL," text at notes 38-39 *infra*; "stripper oil," text at notes 59-60 *infra*; "marginal property," note 113 *infra*; "newly discovered oil," note 110 *infra*; "heavy oil," note 116 *infra*. The price control definition of property is discussed herein in connection with the application of the windfall profit tax. See notes 187, 219 *infra*.

the same month in 1972.³⁹ New oil was the excess, if any, of production in the current month above the BPCL,⁴⁰ and was not generally subject to price controls. Initially, old oil sold for approximately \$4.30-\$4.40 per barrel, while new oil sold, on average, for \$5.30-\$5.40 per barrel.⁴¹

This two tier system was adopted to hold down the average cost of crude oil to refiners while theoretically allowing the market to determine the price of incremental production. The economic effect on production was argued to be the same as that of lifting price controls, although the producer was supposedly denied the economic rents which could be earned on the inframarginal barrel.⁴² It was believed that the two tier price system would contribute to a reduced rate of inflation by lowering the refiner's average cost of acquiring a barrel of crude. To ensure that consumers actually enjoyed lower prices, the Cost of Living Council imposed controls on all phases of the industry, down to the filling station.⁴³

In addition, the initial Cost of Living Council regulations created a "released" oil program. Under the released oil rules, if new oil was produced from the property, the ceiling price on all of the old oil could be increased by an amount which would produce the same benefit as if an amount of old oil equal to the amount of new oil were sold at the uncontrolled price.⁴⁴ The released oil mechanism was adopted in order "to encourage producers to stay at home and work existing reservoirs where it was practical"⁴⁵ This incentive "was included in recognition of the fact that the United States needed more oil as rapidly as possible and the surest way to get more oil was to look for it where it was fairly certain to be found."⁴⁶

The released oil incentive created some potential for abuse. Theoretically, a producer could hold back production one day and obtain a potential surge the next, enabling him to sell more old oil at released oil prices. To prevent such

³⁹ 6 C.F.R. § 150.354(b) (1973). "The property's BPCL was the cornerstone of the Phase IV price regulations." *Southland Royalty Co. v. FEA*, 4 EN. MNGT. (CCH) ¶ 26,234 (N.D. Tex. 1980).

⁴⁰ 6 C.F.R. § 150.354(b) (1973).

⁴¹ Platt's Oil Price Report, Aug. 26, 1973, at 1.

⁴² The theory of production requires that the marginal cost of producing the last unit should be equal to the marginal revenue derived from that unit. E. MANSFIELD, MICRO-ECONOMICS, THEORY AND APPLICATIONS 200 (1975). The theory of production also requires that the marginal cost of producing units other than the marginal unit (the "inframarginal" unit) shall be less than the marginal revenue derived from them. *Id.* Thus, in theory, the Cost of Living Council was attempting through price controls to deny to a producer the excess of marginal revenue over marginal cost for any inframarginal unit.

⁴³ Owens, *supra* note 33, at 1265.

⁴⁴ 6 C.F.R. § 150.354(c) (1973). When the price control regulations were later revised, the released oil rules were simplified. "Released crude oil" was defined as an amount of oil equal to the amount of new oil, and could be sold at new oil prices.

⁴⁵ Owens, *supra* note 33, at 1265.

⁴⁶ *Id.*

abuses, the "cumulative deficiency" rules were introduced.⁴⁷ The "cumulative deficiency" was the aggregate amount by which production fell below the BPCL after the month in which new oil was first produced and sold. The Cost of Living Council required that a producer first sell new oil at old oil prices until he made up for any cumulative deficiency.

To illustrate these rules, consider the following example. John Smith and his family operate Smith Oil Field Number 1, a property with five wells from which a total of 10,000 barrels per day of crude oil was produced in every month during 1972 and through May of 1973. Thus, the BPCL for any month was 10,000 barrels per day. During the balance of 1973, less than 10,000 barrels per day were produced due to various mechanical problems. Thus, from the onset of the price control program in August, 1973, the Smiths were required to sell every barrel of their production at the old oil price since production was less than the BPCL.

In January, 1974, after reworking a well, the Smiths were able to increase production to 10,100 barrels per day. Under the controls program, 100 barrels per day of this production was considered to be new oil and could be sold at uncontrolled prices. In addition, 100 barrels of the 10,000 barrels of production which would otherwise have to be sold as old oil also qualified, in effect, to be sold at uncontrolled prices because it was released oil. Thus, the Smiths were limited to old oil prices on the equivalent of only 9,900 barrels per day of the January, 1974 production.

On February 1, 1974, one of the five wells was shut down for maintenance. Production immediately slumped to 9,000 barrels per day. Since the Smiths had sold oil at new oil prices in a prior month, a cumulative deficiency was created at the rate of 1,000 barrels a day. By March 1, 1974, when production returned to the 10,000 barrel per day level, a cumulative deficiency of 28,000 barrels had accumulated. Accordingly, until production from Smith Oil Field Number 1 exceeded 10,000 barrels per day by an aggregate of 28,000 barrels, the Smiths were not permitted to sell any oil produced from Smith Oil Field Number 1 at new oil prices.⁴⁸ If a new well was completed and operating on May 1, 1974, thereby increasing production from the property to 11,000

⁴⁷ The cumulative deficiency rules initially appeared as a "special release rule." 6 C.F.R. § 150.354(c)(2) (1973). The stated purposes of the cumulative deficiency concept are to preclude the benefits of upper tier prices for mere month-to-month variations in production unless the property was exceeding its BPCL on a cumulative basis, 41 Fed. Reg. 4931 (Feb. 3, 1976), and to provide further incentive to maintain production above the BPCL, 41 Fed. Reg. 1564 (Jan. 8, 1976). The concept of current cumulative deficiency "would act as an additional incentive to maintain increased levels of production, and would prevent producers from building up production inventories for periodic sales, thereby qualifying for new crude oil where there has been no actual increase in cumulative production." *Id.*

⁴⁸ The Smiths would, however, be permitted to sell production from a different property at new oil prices if the production from that property otherwise qualified as new oil.

barrels per day, all production through May 28, 1974, would be sold at the old oil price, even though the BPCL for the property was only 10,000 barrels per day. After May 28, 1,000 barrels per day could be sold as new oil and an additional 1,000 barrels per day could be sold, in effect, as released oil.

2. Stripper Wells and Price Controls

The initial program of price controls was to apply to all oil wells. Owners and operators of stripper wells, principally independent producers, however, did not concur. An amendment exempting stripper oil from controls was introduced in Congress in July, 1973, weeks before Phase IV was even promulgated⁴⁹ and was enacted in November, 1973.⁵⁰ Congress initially provided that production on a lease was exempt from price controls if the average daily production on that lease during the preceding calendar month did not exceed ten barrels per well. The exemption was almost immediately replaced by a similar rule in EPAA based upon lease production during the preceding calendar year rather than the preceding calendar month.⁵¹ Thus, as had occurred with state conservation programs, and would occur with the windfall profit tax, stripper wells were able to avoid significant economic limitations.

3. Price Controls on Crude Oil, 1976-1979

Motivated by the scheduled expiration of price control authority in April, 1975, legislative activity began in January, 1975, that eventually led to substantial revisions of the price control program. In his January 15, 1975, State of the Union message, President Ford announced his intention "to take Presidential initiative to decontrol the price of domestic crude oil on April 1."⁵² At the same time, he proposed that Congress enact a windfall profits tax to "ensure that oil producers do not profit unduly."⁵³

Congress responded with the Energy Policy and Conservation Act (EPCA).⁵⁴ EPCA extended mandatory controls on crude oil for 40 months,⁵⁵ and provided that controls could continue thereafter at the President's discretion until October, 1981.⁵⁶ EPCA required the imposition of regulations that established ceiling prices, or the manner of determining ceiling prices, such that the resulting actual weighted average first sale price for domestically produced crude oil did not exceed a maximum of \$7.66 per barrel, adjusted for in-

⁴⁹ Owens, *supra* note 33, at 1257.

⁵⁰ Trans-Alaska Pipeline Authorization Act of 1973, Pub. L. No. 93-153, § 406, 87 Stat. 576 (1973).

⁵¹ Section 4(e)(2)(A) of EPAA.

⁵² Ford State of the Union Message, January 15, 1975, *reprinted in* 1 EN. MNGT. (CCH) ¶ 691.

⁵³ *Id.* See also note 3 *supra*.

⁵⁴ Energy Policy and Conservation Act, Pub. L. No. 94-163, 89 Stat. 871 (1975).

⁵⁵ To June, 1979.

⁵⁶ Section 461 of EPCA, adding new § 18 to EPAA.

flation. Considerable administrative discretion was delegated to determine the manner in which the weighted average rule would be met. In addition, although crude oil price ceilings were required to be lowered if it were found that the actual weighted average exceeded the \$7.66 limit,⁵⁷ additions to oil prices to compensate for an actual weighted average that fell below the limit were discretionary.⁵⁸

Price controls on stripper oil were reimposed by EPCA. Congress retreated from this action seven months later, however, when price controls were lifted from stripper oil under the Energy Conservation and Production Act (ECPA).⁵⁹ ECPA specified that crude oil production was not subject to price controls "from a property whose maximum average daily production of crude oil per well during any consecutive 12-month period beginning after December 31, 1972, does not exceed 10 barrels." Once qualified for this status, the property remained permanently qualified regardless of future production volume.⁶⁰ Thus EPCA effected significant changes in the price control program. Additionally, because of the broad administrative discretion provided by the Act, those charged with implementing it were given flexibility in classifying oil in tiers and extensive authority to set prices for the various tiers of crude oil.

4. Implementation of EPCA Amendments

a. *The Price of Alaskan Oil*

In 1973, when price controls were first imposed, oil had been discovered in the Sadlerochit field at Prudhoe Bay, on Alaska's North Slope. Production could not take place, however, until 1977, when the Trans-Alaska Pipeline System was completed. EPCA permitted the President to exempt up to 2 million barrels per day of oil transported through the Alaska pipeline (Alaskan North Slope, or ANS oil) from the computation of the maximum average first sale price and, instead, specify a price, or manner of determining prices, of ANS oil such that the average first sale price was no higher than the highest price for any other classification of domestic crude.⁶¹ This discretion was provided to encourage production of ANS oil without discouraging production in the lower 48 states.⁶²

Since the wellhead price of ANS oil was less than the mandated weighted average, inclusion of ANS oil in the weighted average computation would have created administrative flexibility to increase ceiling prices on other types of

⁵⁷ Section 401(a) of EPCA, adding new § 8(c)(2) to EPAA.

⁵⁸ Section 401(a) of EPCA, adding new § 8(c)(3) to EPAA.

⁵⁹ Energy Conservation and Production Act, Pub. L. No. 94-385, 90 Stat. 1125, § 121 (1976), adding new § 8(i) to EPAA.

⁶⁰ This rule is referred to as "once a stripper, always a stripper."

⁶¹ Section 401(a) of EPCA, adding new § 8(g)(2) to EPAA.

⁶² S. REP. NO. 94-516, 94th Cong., 1st Sess. 194 (1975).

oil.⁶³ Consequently, in April, 1977, President Carter elected to include ANS production in the weighted average price computation. Since ANS oil was classified as upper tier oil, the maximum ceiling price on ANS oil was established initially as \$10.87 per barrel and allowed to increase with inflation. At the time the decision was made, subjecting ANS oil to the upper tier ceiling price was equivalent to exempting the production from crude oil price controls, because, after subtracting transportation costs of approximately \$7.00 per barrel (\$5.50 for the pipeline and \$1.50 for shipping from Valdez to U.S. refiners) from the market price of \$13.60 at the refinery, the oil could command no more than \$6.80 at the wellhead.

b. *Modification of Base Production Control Levels*

EPCA implied that the definition of old oil should be determined with respect to production of old crude oil, determined under existing rules, in the last three months of 1975.⁶⁴ The Federal Energy Administration responded by providing generally that BPCL's would be equal to the corresponding monthly production of old crude oil in 1975.⁶⁵ It was concluded that this revision eliminated the need for continuing the released oil program,⁶⁶ which was therefore terminated.⁶⁷

EPCA also authorized adjustment to BPCL's if "necessary to take into account declining production from such properties," thus recognizing the physical decline process for the first time.⁶⁸ The Federal Energy Administration created a new definition, the "adjusted base production control level" (ABPCL), to implement this change.⁶⁹ For properties where no new crude oil had been produced in any month from February through June, 1976, a pro-

⁶³ In early 1977, the mandated weighted average price of nonstripper oil was limited to approximately \$8.50 per barrel, whereas the wellhead price of ANS oil was less than \$7.00 per barrel. Thus, by including ANS oil in the weighted average price calculation, the price on *other* controlled oil could be increased without violating the weighted average limitation.

⁶⁴ Section 401(a) of EPCA, adding new § 8(b)(3) to EPAA.

⁶⁵ 10 C.F.R. § 212.72 (1976).

⁶⁶ 41 Fed. Reg. 1564 (Jan. 8, 1976).

⁶⁷ The Federal Energy Administration's rationale is best explained by an example. Suppose additional wells were drilled in Smith Oil Field Number 1 to increase production in 1975 to 12,000 barrels per day. Under pre-EPCA regulations, recalling that the BPCL for the property was 10,000 barrels per day, 2,000 barrels per day would qualify to be sold as new oil, and, under the released oil rules, an additional 2,000 barrels per day could also be sold as new oil. Consequently, only 8,000 barrels per day were required to be sold as old oil. Under the post-EPCA regulations, since 1975 old oil production was 8,000 barrels per day, the post-EPCA BPCL was set equal to 8,000 barrels per day. Thus, if 1976 production continued at 12,000 barrels per day, 4,000 barrels per day would be new oil, and 8,000 barrels per day would be old oil.

⁶⁸ Section 401(a) of EPCA, adding new § 8(b)(2)(B) of EPAA. It was noted above, see text *supra* at notes 16-19, that production tends to decline over time as oil is drawn from the reservoir. This decline can be counteracted by additional investments, the costs of which increase steadily over time. By providing two barrels of decontrolled oil for every one barrel produced in excess of the BPCL, the released oil program created meaningful investment incentives for old oil fields. Elimination of the released oil program made investment in secondary and tertiary recovery less economic. Thus, absent further regulatory change, additional investments necessary to arrest the rate of decline in old oil fields would likely not have been made.

⁶⁹ 10 C.F.R. § 212.76, 41 Fed. Reg. 15566 (Apr. 13, 1976).

ducer was permitted, beginning on July 1, 1976, to reduce the BPCL for his property. During the six-month period from July 1, 1976, to December 31, 1976, the rate of adjustment was three-quarters of the average annual rate of decline on the property between 1972 and 1975. For each successive six-month period, the rate of adjustment was half the annual rate of decline between 1972 and 1975.⁷⁰ Similar adjustments were provided for properties where production of new crude oil occurred in any month between February and June, 1976, except that the first adjustment was delayed until after production from the property fell below the aggregate BPCL for a six-month period ending after June 30, 1976.⁷¹

If in the Smith Oil Field Number 1 example,⁷² new oil was produced from February to June, 1976, no adjustment in the BPCL could be made until production fell below the aggregate BPCL for six months. Assuming the BPCL was 8,000 barrels per day, no adjustment of the BPCL could be made until production averaged less than 8,000 barrels per day for a six-month period ending after June 30, 1976. If production was at 12,000 barrels per day, the adjustment would not affect Smiths' ceiling price for many months. Moreover, any eventual adjustment would not be significant because there was no appreciable rate of decline between 1972 and 1975. Thus, although the ABPCL concept was a step in the right direction because it recognized the physical decline process, it was flawed because it took no account of why declines did or did not occur.

c. *Modification of Regulations to Encourage Enhanced Recovery*

As an additional incentive to increase production, regulations designed to encourage enhanced recovery projects were also promulgated. Like the ABPCL program, however, these rules were insufficient to produce the desired result. Enhanced oil recovery is "the recovery of oil from a petroleum reservoir resulting from application of a recovery process beyond secondary oil recovery."⁷³ Secondary recovery has no precise definition, but usually refers to the injection of water or gas to increase pressure in an oil reservoir.⁷⁴ Examples of enhanced recovery are thermal recovery, miscible flooding, and chemical flooding.⁷⁵ In general it is recognized that enhanced recovery can substantially

⁷⁰ Thus, if the annual rate of decline for a property was 12 percent and the initial BPCL was 1,000 barrels per day, the ABPCL during the first six months would be 910 barrels per day (calculated by multiplying 1,000 by $(1 - [3/4][.12])$), while the ABPCL for the next six-month period would be 855.4 barrels per day (obtained by multiplying 910 by $(1 - [1/2][.12])$).

⁷¹ 10 C.F.R. § 212.76, 41 Fed. Reg. 15566 (Apr. 13, 1976).

⁷² See text following note 46 *supra* through the end of § I.B.1. *supra* and note 67 *supra*.

⁷³ ENERGY INFORMATION AGENCY, U.S. DEP'T OF ENERGY, ANNUAL REPORT TO CONGRESS 219, 224 (1980).

⁷⁴ See, e.g., A. J. BRUEN AND W. B. TAYLOR, FEDERAL INCOME TAXATION OF OIL AND GAS INVESTMENTS 13-8 (1980).

⁷⁵ Thermal recovery involves injecting heat into the reservoir; miscible flooding involves injecting a material such as carbon dioxide which is miscible with water into the reservoir; and chemical flooding involves injecting a mixture of chemicals and water into the reservoir.

increase the amount of oil that can be recovered from a reservoir, but at an increased cost. For example, a National Petroleum Council report noted that average recovery for U.S. oil fields using conventional methods was perhaps only one-third of all oil in place, and would yield a total of roughly 100 billion barrels. Enhanced recovery methods were expected to increase the volume of recovery by as much as 24 billion barrels.⁷⁶ The National Petroleum Council report noted, however, that the results were uncertain because the technology was unproven, and investment was highly sensitive to economics, including price regulations, tax treatment,⁷⁷ and the world price of oil.⁷⁸

Both EPCA and ECPA encouraged the Federal Energy Administration to foster the development of enhanced recovery through modifications of the crude oil price regulations.⁷⁹ The initial DOE enhanced recovery regulations, issued in August of 1978,⁸⁰ imposed stringent requirements and did not significantly alleviate the uncertainties noted by the National Petroleum Council.⁸¹

Initially, the price control benefit, deregulation, applied only to incremental production.⁸² The Federal Energy Administration defined incremental production in the following manner:

Incremental crude oil (resulting from the implementation of a qualified tertiary enhanced recovery project) means, in the case of a new project, the amount of crude oil which is or will be produced as a result of such a project and which is in excess of the amount of crude oil ("non-incremental crude oil") which could have been produced from the property or project area through continued maximum feasible production from methods of production employed on the property prior to the receipt of certifications provided for in paragraph (d) of this subsection.⁸³

⁷⁶ THE NATIONAL PETROLEUM COUNCIL, ENHANCED OIL RECOVERY 3-5 (1976).

⁷⁷ The most important tax question pertained to the capitalization or expensing of some tertiary expenditures. This problem is now addressed by I.R.C. § 193, added by § 251(a)(1) of the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, effective for taxable years beginning after Dec. 31, 1979. Section 193 allows a current deduction for certain tertiary injectant expenses.

⁷⁸ THE NATIONAL PETROLEUM COUNCIL, ENHANCED OIL RECOVERY 3-5, 53-54 (1976).

⁷⁹ Section 401(a) of EPCA, adding new §§ 8(b)(2)(A)(i) and 8(d)(3)(B) to EPAA; § 122 of ECPA, adding new § 8(j) to EPAA.

⁸⁰ Section 122 of ECPA was implemented by a notice of proposed rulemaking, 42 Fed. Reg. 2646, Jan. 12, 1977, a notice of decision, 42 Fed. Reg. 41572, Aug. 17, 1977, and the August 1, 1978 final rule.

⁸¹ These stringent requirements were followed in early drafts of the windfall profit tax, but were eventually replaced by more liberal provisions. See text at notes 202-15, 270-82, and 363-69 *infra*.

⁸² 10 C.F.R. § 212.78(a)(1)(A), 43 Fed. Reg. 33679 (Aug. 1, 1978).

⁸³ 10 C.F.R. § 212.78(c), 43 Fed. Reg. 33679 (Aug. 1, 1978) (definition of "incremental crude oil"). A similar definition applied for increased production from existing enhanced recovery projects.

Non-incremental production from the project could be sold only for the price it otherwise would have received. The Federal Energy Administration was required to determine, on the basis of an application, whether the project qualified and, if it did, the amount of incremental and non-incremental crude oil.⁸⁴ A project could not be certified:

unless it [was] determined that, under all the circumstances, the producer could not reasonably be expected to undertake (or expand or continue) the project in the absence of an ability to charge prices for the expected incremental crude oil in accordance with paragraph (a), because the project would not be economic under the otherwise applicable ceiling price.⁸⁵

In summary, a producer was allowed to receive uncontrolled prices for incremental production only upon a showing that the incremental production, determined in accordance with stringent standards, would not be profitable in the absence of the incentive.

Not surprisingly, the incremental tertiary regulations failed to inspire a large number of new enhanced recovery projects.⁸⁶ The regulations were perceived as granting an inadequate benefit under uncertain conditions.⁸⁷ In addition, other regulatory action suggested that the amount of decontrolled incremental tertiary oil might be reduced to reflect deregulation benefits granted elsewhere.⁸⁸

5. Detriments of Price Controls

The system of price controls on domestic crude oil and oil products and the related system allocating the benefits of controlled oil to refiners presented consumers of oil with a price below the replacement cost set by world markets. Consequently, the economic benefits of price controls served to subsidize the consumption of oil, which, in turn, increased oil imports.⁸⁹ For example, in

⁸⁴ 10 C.F.R. § 212.78(d)(2), 43 Fed. Reg. 33679 (Aug. 1, 1978).

⁸⁵ *Id.*

⁸⁶ OIL & GAS J., Aug. 28, 1978, at 42. At the time crude oil decontrol was being debated in January, 1979, one of the authors, who was then an official of the U.S. Treasury Department, was told by DOE officials that there had been one application in the first six months of the enhanced recovery program.

⁸⁷ OIL & GAS J., Sept. 11, 1978, at 38.

⁸⁸ Under a companion proposal to the incremental tertiary rules, price controlled oil could be deregulated in order to finance the cost of tertiary projects. Such benefits, however, would reduce the amount of oil eventually decontrolled as a result of implementing the tertiary project. 43 Fed. Reg. 33679 (Aug. 1, 1978). See also note 112, *infra*.

⁸⁹ As a consequence of oil price controls, prices paid for petroleum products were reduced by four to ten cents per gallon, thereby increasing the demand for petroleum products. See J. Kalt, *Federal Regulation of Petroleum Prices: A Case Study in the Theory of Regulation* (1980) (unpublished Ph.D thesis on file at the University of California at Los Angeles; to be published by MIT press). Since 1973, the marginal barrel of crude oil has been supplied by oil imports. See text at notes 33-34 *supra*. Therefore, a marginal increase in the U.S. demand for oil

February, 1979, the landed cost of imported oil was \$15.80 per barrel, while the average refiner price for oil, reflecting the benefits of price controls, was \$13.24 per barrel. Thus, at that time, domestic oil regulation created a subsidy of \$2.56 per barrel to consumers to increase oil imports. Similarly, by lowering the cost of oil, price controls subsidized the consumption of oil and energy, and discouraged energy conservation and the use of alternative energy sources.

In addition, price controls on domestic oil discouraged domestic oil production. Use of historical decline rates in the calculation of ABPCL's provided an inadequate incentive to increase production. To the extent that production from a property declined below the BPCL or ABPCL and a cumulative deficiency developed, a producer evaluating an investment to increase production would compute the revenues from incremental production from the investment at the old oil price. Thus, to the extent that the per barrel cost of an investment to increase production was greater than the old oil price but less than the new oil price, the investment would lose money and hence not be made, even though the production was incremental and the national interest was served by increased oil production.

For example, in October, 1978, the Smiths could have shut down a well in Oil Field Number 1 for one week to undertake maintenance that would increase production from that well from the current level of 100 barrels per day to 120 barrels per day, and increase cumulative production by 14,000 barrels over two years. Due to a current cumulative deficiency for Field Number 1, however, none of the incremental production could be sold at the upper tier price. Thus, unless the maintenance could be accomplished for less than \$70,000, the approximate present value of the increased income that would be realized by selling the increased production at the old oil price, the Smiths would lose

and oil products results in a corresponding increase in oil imports. Thus, the effect of oil price controls, by lowering product prices and increasing the demand for oil, has been to cause oil imports to be higher than they would have been in the absence of price controls.

A regulatory system comprised solely of price controls on domestically-produced oil would not have lowered prices of petroleum products to consumers, and therefore would not have increased demand for imported oil (except to the extent that controls caused production of U.S. oil to decline), since the financial benefits of price controls would have been captured entirely by U.S. refiners. Under such a system, since oil imports provide marginal supplies, refiners would have continued to pay the world price for their incremental crude oil, notwithstanding the savings realized from purchasing price-controlled domestic oil. Since the price of petroleum products to consumers is determined by the price of incremental oil supplies, consumer prices would remain determined by the price of imported crude oil. Thus, in the absence of further market intervention, the benefits of oil price controls would not be passed on to consumers.

In November, 1974, however, a second regulatory program was adopted for the express purpose of allowing all refiners to share equally in the benefits of price-controlled oil. By spreading the financial benefits of price-controlled oil equally among refiners, this program, referred to as the entitlements system, had the effect of reducing the marginal cost of crude oil to all refiners by an identical amount. As a result, since the price of petroleum products is determined by the marginal cost of crude oil, the price of petroleum products to consumers was reduced accordingly. Thus, the entitlements system transferred the benefits of oil price controls to consumers, leading to increased demand for oil products that could be satisfied only from increased oil imports.

money by undertaking the investment. If, on the other hand, the 14,000 incremental barrels could be sold at new oil prices, the Smiths might be willing to proceed with the maintenance as long as the cost was less than roughly \$175,000, the value of the incremental production if it could be sold for the new oil price. Thus, cumulative deficiencies tended to discourage investments to increase production. Cumulative deficiencies were, however, only one example of the production disincentives built into the price control program.

There were several other problems with the structure of the program. One problem was the setting of decline rates for individual properties. Since April, 1976, decline rates had been reflected in adjustments to BPCLs based upon property by property experience. Unfortunately, the historical periods used to establish decline rates created inequities. During those periods, the federal government urged producers to increase production. Those producers who responded received low decline rates under the price control regulations, thereby increasing their exposure to old oil treatment. In fact, a producer who maintained a constant rate of production during the periods used to determine decline rates was forced continually to expand development every year simply to avoid cumulative deficiencies. A producer who did not respond at all to the appeal to increase production and who allowed production to decline at a high rate was considered to have a high historical decline rate. Consequently, the unresponsive producer could sell a smaller and smaller volume of production at old oil prices.⁹⁰ Thus, incremental production that resulted from additional investment made after 1975 generally qualified for new oil price treatment if produced on a property where little effort had been made to increase production from 1973 to 1975, while usually being treated as old oil on properties where the effort had been made. Use of historical decline rates, therefore, tended to discourage increases in production.⁹¹

A second problem was created by the stripper oil exemption.⁹² The economic effect of this exemption was frequently to make further investments in oil fields unprofitable until a property qualified for stripper status. There are actions that a producer can take to increase the flow of oil from a property, including water injection and workovers. By postponing such actions, production from a property could be allowed to decline more rapidly while still proceeding at the maximum efficient rate, thereby accelerating the achievement of stripper status. Once this status was achieved, the deferred investment could be made, increasing production above the 10 barrel a day limit. Since the law specified that wells qualifying as stripper wells were permanently exempt from price controls, the increased production would not be controlled.

⁹⁰ Furthermore, had he succeeded in reducing production over a 12-month period to 10 barrels a day or less, his production would have qualified as stripper oil, and would have been permanently exempt from price controls. See text at notes 59-60 *supra*.

⁹¹ If, however, a uniform decline rate for all properties were used which generally exceeded historical decline rates, the historically diligent producer would not be treated unfairly and would not be discouraged from increasing production.

⁹² See text at notes 49-50 and 59-60 *supra*.

For example, suppose production from Smith Oil Field Number 2, an old oil property, averaged 12 barrels a day during July, 1977, and, through natural decline, would probably qualify as exempt stripper production by January 1, 1979. Under the regulatory program that existed from 1976 to 1979, the Smiths could anticipate receiving approximately \$6.00 per barrel until December, 1978. Thereafter, all production from Smith Oil Field Number 2 would qualify for the uncontrolled price, then approximately \$13.25 per barrel. On the other hand, if the Smiths made investments in July, 1977, to increase production, the investment would delay the date the property would qualify for stripper status. Such an investment might raise average output to 14 barrels per day and the two incremental barrels per day might qualify for new oil prices.⁹³ In January, 1979, however, the incremental production would prevent the well from qualifying for stripper status. Therefore, beginning January, 1979, the investment would *reduce* revenue from Smith Oil Field Number 2 by approximately \$36.00 per day⁹⁴ below that which would have been realized had no investment been made. The potential loss in revenues resulting from efforts to increase production could be avoided by delaying the investment. If the Smiths waited until January, 1979, to make their investment, their property would have permanently qualified for stripper status, and all production would receive uncontrolled prices. Thus, the statutory and regulatory regime encouraged producers to delay investments.⁹⁵ This delay reduced U.S. oil production.

6. The November, 1978 Notice

In November, 1978, DOE published a notice in the Federal Register that solicited comments on alternative proposals for incentives to encourage in-

⁹³ As noted above, however, it is more likely that the two incremental barrels would have qualified for old oil treatment. See text at notes 90-91 *supra*.

⁹⁴ Assume that in January, 1979, production from the property is eight barrels per day absent the investment, and ten barrels per day with the investment. Since, absent the investment, the property qualified for stripper status at the end of 1978, the eight barrels per day of production may be sold for the uncontrolled price of \$13.25 per barrel, for total revenues of \$106 per day. If the investment is made, at most two of the ten barrels per day of production will qualify for the new oil price of \$11 per barrel; the balance will be sold as old oil at \$6 per barrel. Thus, with the investment, total revenues will be \$70 per day. Consequently, in January, 1979, the investment has reduced revenues by \$36 per day.

⁹⁵ Premier Consolidated Oil Fields, Ltd., an English firm, even described its action in its annual report:

Production from six leases owned by Premco Petroleum Incorporated, the company's U.S. subsidiary, in the Midway Sunset Field in California gave good returns during the past year as shown in the accounts. Over a year ago the decision was taken to terminate the steam drive operation in the Metson lease and consequently there was a sharp drop in production. However, since lease oil was not being consumed to produce steam, revenues fell only slightly. In September, 1977, the Metson reached "stripper status," average production per well below ten barrels per day, which permitted the oil to be sold at much higher prices under government regulations. Accordingly it became economic to resume steaming and

creased production of domestic crude oil.⁹⁶ The proposals contained in the November, 1978, notice reflected in part the production disincentives discussed above, and eventually defined the parameters of the discussion of oil price decontrol.⁹⁷ In the November, 1978, notice, the following proposals were presented:

a. *Marginal Oil*

DOE proposed to decontrol production from a marginal property in excess of that property's BPCL.⁹⁸ DOE solicited comments on the definition of a marginal property and the determination of decontrolled production.

b. *Updating Base Production Control Levels*

DOE also proposed to update BPCLs for all properties.⁹⁹ Under this proposal DOE suggested that the BPCL might be based upon 1977 production instead of the three-month period in 1975 that had been established in EPCA. The proposal also indicated that the producer would be able to eliminate any current cumulative deficiency, thus permitting a "fresh start". The proposal would allow producers to receive upper tier prices for production that is in "excess of the property's more recent decline rate without requiring the producer to 'pay back' from such increased production the amount by which prior production was less than the property's prior BPCL."¹⁰⁰ DOE also suggested that producers might be allowed to compute their decline rates using the average decline rate for any three consecutive years from 1972 to 1978.

c. *Decontrol Some Production from All Wells*

A third proposal suggested by DOE would have allowed producers of old oil to sell a certain volume of crude oil from each well on a property at the market price, effectively giving all wells the advantage accorded to stripper wells for the initial production. The rationale of this proposal was that it would "counteract any tendency of producers to refrain from stimulating recovery, but instead allow production to decline normally, in order to qualify for strip-

this was done in October with a sharp increase in production as a result; over 500 barrels per day from September to December.

Premier Consolidated Oil Fields, Limited, Report and Accounts, 1978, at 10.

⁹⁶ 43 Fed. Reg. 52186 (Nov. 8, 1978), supplemented by Notice of Proposed Rulemaking, 44 Fed. Reg. 892 (Jan. 3, 1979).

⁹⁷ The only other preliminary action was the publication of a proposal to deregulate newly discovered oil. 44 Fed. Reg. 1888 (Jan. 8, 1979).

⁹⁸ 43 Fed. Reg. 52186 (Nov. 8, 1978).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

per well pricing under the current regulations."¹⁰¹ Alternatively, the proposed benefit might be limited only to properties that have secondary or tertiary recovery projects.

d. *Raise the Price of Lower Tier Crude Oil*

As a final alternative, DOE asked whether the ceiling price for lower tier crude oil should be increased because costs of maintaining oil production were increasing faster than the gross national product deflator, the measure of inflation used to adjust ceiling prices. DOE asked for information to determine whether operating costs were rising to the currently permitted ceiling price.

The proposals made by the November, 1978 notice helped formulate the alternatives for implementing decontrol of domestic crude oil prices. Although the November, 1978 proposals were not explicitly adopted, much of their substance was incorporated in various aspects of the Carter decontrol program.

Section I of this article surveyed the development of domestic oil price controls from the 1971 wage and price freeze through 1978. The controls system defined a standard of production — the BPCL — for each property in order to implement a ceiling price distinction between pre-1973 production and post-1972 production. Price controls were then imposed separately on old oil and new oil. In addition to noting this development, Section I reviewed the special treatment under price controls accorded Alaskan oil, stripper oil, and incremental production from tertiary projects. The discussion then considered the major problems of price controls, including the subsidization of domestic oil consumption, increased demand for oil imports, and discouragement of domestic oil production and the development of alternative energy sources. The November, 1978 DOE notice tentatively addressed certain of these problems, and became the starting point for the next phase of domestic oil policy, the Carter Administration's decontrol and windfall profit tax proposals described below.

II. DECONTROL AND THE WINDFALL PROFIT TAX

A. *The Administration's Proposal*¹⁰²

In April, 1979, the Carter Administration adopted a domestic crude oil policy consisting principally of phased decontrol of domestic crude oil prices,

¹⁰¹ *Id.*

¹⁰² The Administration's decontrol and windfall profit tax proposals were released and explained in a series of documents and statements. The initial description was provided in an address to the nation by the President on April 5, 1979. President Carter's Energy Address to the Nation, 15 WEEKLY COMP. OF PRES. DOC. 609 (Apr. 5, 1979) [hereinafter cited as *President's April, 1979 Energy Address*]. The *President's April, 1979 Energy Address* was accompanied by an explanatory fact sheet. White House Fact Sheet on the President's Program, Office of the White House Press Secretary, Apr. 5, 1979, reprinted in 1 EN. MNGT. (CCH) ¶ 761 [hereinafter cited as *April, 1979 Fact Sheet*]. The initial description was amplified in a message to Congress. President's

and a windfall profit tax related to, but not a precondition for decontrol.¹⁰³ The decontrol program is described below, followed by a discussion of the windfall profit tax proposal.

1. Decontrol¹⁰⁴

The decontrol program was the result of an intense six-month debate within the Administration, which led to the following conclusions. First, complete decontrol of all crude oil on June 1, 1979, would be ill-advised because of unacceptable impacts on the rate of inflation. Consequently, phased decontrol should be adopted so that by October 1, 1981, the scheduled expiration of price control authority, full decontrol will have been achieved. Second, decontrol should be implemented by gradually decreasing the volume of oil subject to controls, rather than by gradually increasing ceiling prices to market prices. Volumetric decontrol could be effected through a simple, pre-set formula. By contrast, requisite ceiling price increases would be dependent on subsequent world price changes, and, therefore, would be difficult to implement evenly,

Message to Congress Transmitting Windfall Profits Tax and Energy Security Trust Fund, 15 WEEKLY COMP. OF PRES. DOC. 721 (Apr. 26, 1979) [hereinafter cited as *President's April, 1979 Energy Message*]; Remarks on Signing President's April, 1979 Energy Message, 15 WEEKLY COMP. OF PRES. DOC. 728 (Apr. 26, 1979). A draft bill "embodying" the President's proposal, with some "technical amendments," was introduced by Congressman Ullman, then Chairman of the House Ways and Means Committee. H.R. 96-3919, 96th Cong., 1st Sess. (May 9, 1979) [hereinafter cited as the *Ullman Bill*]; see 125 CONG. REC. H2675 (daily ed. May 3, 1979) (remarks of Rep. Ullman). Finally, the Secretary of the Treasury explained the windfall profit tax in testimony before the House Ways and Means Committee. *Windfall Profits Tax and Energy Trust Fund: Hearings Before the House Comm. on Ways and Means*, 96th Cong., 1st Sess. 6-66 (1979) (statement of W. Michael Blumenthal) [hereinafter cited as *Ways and Means Committee Hearings*].

¹⁰³ The April, 1979 policy reflected the major objections to the Carter Administration's first domestic oil policy, which consisted principally of continued price controls and the proposed crude oil equalization tax. See note 3 *supra*. Under the earlier policy, Congress was required to take the initiative, and, therefore, the responsibility, for raising oil prices, and producers received no benefits. Under the revised policy, since decontrol, rather than a tax, would raise oil prices, the President, not Congress, would appear to bear the responsibility for raising prices. Moreover, through decontrol, oil producers would receive benefits, subject to the proposed windfall profit tax. The proposed tax was made independent of decontrol since the energy policy benefits flowed from decontrol; the tax was perceived more as an equity measure. In addition, the President had only a limited period of time — until October 1, 1981 — within which to phase in deregulation administratively.

¹⁰⁴ In the spring of 1979, domestic oil usage was as follows. Imports totalled approximately eight million barrels per day at a landed cost of approximately \$16 per barrel. (By the end of 1979, this cost would nearly double.) Domestic production was 8.5 million barrels per day. Lower tier oil, controlled at an average price of approximately \$6 per barrel, comprised about one-third of domestic production. (One-fourth of lower tier oil was thought to consist of marginal oil. See note 113 *infra*.) Upper tier oil was controlled at an average price of approximately \$13 per barrel, and also comprised about one-third of domestic production. Alaska North Slope oil, about 14 percent of domestic production, although technically controlled at an upper tier ceiling price of \$13 per barrel, actually sold for a wellhead price of approximately \$7-8 per barrel. Uncontrolled oil, consisting mostly of stripper oil, comprised 15 percent of domestic production, and sold for slightly less than \$16 per barrel.

and would be more vulnerable to administrative recalcitrance. If deferral of ceiling price increases occurred, a large gap might remain between controlled and market prices on October 1, 1981, which could stimulate legislative action for continued controls.

The economic justification for decontrol was described in some detail by the President:

The gradual deregulation of domestic oil prices will bring the price of oil to world oil price levels, with the following benefits: First, it will eliminate the current subsidy provided to imported oil, which has increased consumption and dependence on foreign supplies. Second, it will encourage producers of oil to seek out additional supplies and to continue production from marginally economic operations. Third, decontrol will phase out the complex system of controls which presently produces inequities and inefficiencies. Fourth, through replacement cost pricing, new sources of energy will come into commercial use, further reducing U.S. dependence on foreign oil. Fifth, it will strengthen the stability of the dollar and reduce balance of payment flows, both directly through reduced oil payments abroad and indirectly through confidence that the U.S. is attacking its energy problem.¹⁰⁵

Phased decontrol was adopted "in order to minimize sudden economic shock"¹⁰⁶ and to "ensure that decontrol does not add unnecessarily" to inflation.¹⁰⁷

The program of phased decontrol included some of the elements described in the November, 1978, notice. New categories of oil would be defined and decontrolled, partially or completely, in order to provide "special new incentives to those categories of oil where the maximum amount of new exploration and production will result."¹⁰⁸ In addition, the balance of controlled oil would be gradually deregulated, a process that would begin generally on January 1, 1980, and end on October 1, 1981.¹⁰⁹

The special incentive categories consisted of newly discovered oil, margin-

¹⁰⁵ *President's April, 1979 Energy Message*, *supra* note 102, at 721-22. This statement should be contrasted with the Administration's policy two years earlier: "The President is committed to the retention of domestic oil price controls for the foreseeable future to prevent windfall profits for oil producers who would otherwise be able to charge the OPEC-determined world price of oil." National Energy Program, Fact Sheet on The President's Program, 13 WEEKLY COMP. OF PRES. DOC. 573, 580 (Apr. 20, 1977).

¹⁰⁶ *President's April, 1979 Energy Address*, *supra* note 102, at 610.

¹⁰⁷ *April, 1979 Fact Sheet*, *supra* note 102, at 10.

¹⁰⁸ *Id.* at 9.

¹⁰⁹ Under EPCA, the expiration of price controls was authorized as of June 1, 1979, and all statutory authority to impose oil price controls expired on October 1, 1981. Section 461 of EPCA, adding new § 18 to EPAA.

al production, incremental production attributable to certain enhanced recovery techniques, and heavy oil. As of June 1, 1979, newly discovered oil¹¹⁰ and the incremental production resulting from introducing tertiary recovery

¹¹⁰ Newly discovered oil was defined as domestic crude oil which is (1) produced from a lease on the Outer Continental Shelf entered into after 1978 of an area from which there was no production in 1978, or (2) produced from a property (other than on the Outer Continental Shelf) from which no crude oil was produced in 1978. 10 C.F.R. § 212.79, 44 Fed. Reg. 25828 (May 2, 1979). The Notice of Proposed Rulemaking for newly discovered oil was issued on January 8, 1979, and was described as being a part of the implementation of President Carter's April 20, 1977, National Energy Plan. 44 Fed. Reg. 25828 (May 2, 1979). See National Energy Program, Fact Sheet on the President's Program, 13 WEEKLY COMP. OF PRES. DOC. 573, 578 (Apr. 20, 1977); NATIONAL ENERGY PLAN, *supra* note 2, at 50-51; 44 Fed. Reg. 1888 (Jan. 8, 1979) (Notice of Proposed Rulemaking). The April 20, 1977, proposal differed substantially, however, from the final rule adopted on May 2, 1979. Under the earlier proposal, newly discovered oil would have been defined as oil from a well drilled more than 2½ miles from an existing onshore well as of April 20, 1977, or more than 1,000 feet deeper than any well within any 2½ mile radius. Newly discovered offshore oil was to be oil from lands leased after April 20, 1977. The price of newly discovered oil would have been allowed to increase to the then current world price, but only over a three-year period. Thereafter, the price would have been adjusted only for inflation.

On June 23, 1980, a proposal was issued to amend the newly discovered oil rules. 45 Fed. Reg. 42222 (June 23, 1980). The initial definition of newly discovered oil required that no crude oil be produced from a property in 1978. The June 23, 1980 proposal set forth two alternatives, each of which would have expanded the definition of newly discovered oil by restricting the 1978 production limitation: (1) that no crude oil be produced *and sold* from the property in 1978, or (2) that no crude oil be produced *and sold in commercial quantities* in 1978. The proposal added the following:

The Conference Report on the Windfall Profit Tax Act of 1980 states that, for purposes of the windfall profit tax, newly discovered oil includes production from a property which did not produce oil in commercial quantities during calendar year 1978. The Report also indicates that commercial production does not include production which is incidental to the drilling of exploratory or test wells and which is not continuous. Comments on what constitutes commercial quantities should address the language in the Report and also the degree of need for uniformity in the definition of "newly discovered crude oil" for purposes of DOE's pricing regulations and for purposes of the windfall profit tax.

45 Fed. Reg. at 42223 (June 23, 1980). In DOE Ruling 1980-3, July 14, 1980, DOE took the position that oil produced during well tests constituted "production" for purposes of the definition of newly discovered oil, and rejected the above-cited conference report interpretation. Ruling 1980-3 was found to be a reasonable interpretation of "production" in *Williams Exploration Company v. DOE*, 4 EN. MNGT. (CCH) ¶26,271 (N.D. Okla., Dec. 24, 1980).

On November 18, 1980, DOE revised the definition of newly discovered oil, effective after December, 1980, to include properties "from which no crude oil was produced and sold in commercial quantities in calendar year 1978." 10 C.F.R. §§ 212.72 (definition of "produced and sold") and 212.74(b) (definitions of "newly discovered crude oil" and "newly discovered crude oil property"), 45 Fed. Reg. 78588 (Nov. 25, 1980). Prior to 1981, the interpretation expressed in DOE Ruling 1980-3 appears to govern the definition of newly discovered oil. 45 Fed. Reg. 78588 n.2. DOE believes that its revision "should result in a similar meaning for newly discovered crude oil under our regulation and under whatever regulations that the IRS ultimately adopts for purposes of the Windfall Profit Tax." 45 Fed. Reg. at 78590. Certain administrative provisions promulgated in the November 18, 1980, final rule were later deleted in response to President Reagan's decision on January 28, 1981, to decontrol all domestic crude oil. 46 Fed. Reg. 11804 (Feb. 11, 1981). See note 122 *infra*.

programs¹¹¹ would be decontrolled. In addition, beginning on January 1, 1980, producers investing in enhanced recovery projects would be able to decontrol certain volumes of lower tier oil to finance the investment.¹¹² As of June 1, 1979, 80 percent of all production from marginal properties would be released to upper tier prices.¹¹³ The balance of marginal well production was to be

¹¹¹ Incremental production from implementation of qualified tertiary enhanced recovery projects had already been decontrolled effective September 1, 1978. 10 C.F.R. § 212.78, 43 Fed. Reg. 33679 (Aug. 1, 1978). See text at notes 79-88 *supra*. Thus, the June 1, 1979, effective date used by the President appears to be inaccurate. The incremental tertiary oil regulations were subsequently amended to coordinate properly with the decontrol of lower tier oil. 10 C.F.R. § 212.78(g)(1) (last sentence), 45 Fed. Reg. 47622 (July 15, 1980).

¹¹² 10 C.F.R. § 212.78, 44 Fed. Reg. 51148 (Aug. 30, 1979). The price benefit attributable to the released lower tier oil became known as "front-end" tertiary money, and the released oil as "front-end tertiary" oil. The front-end money rule was proposed prior to the President's April, 1979, Energy Address, and was an alternative to a proposal arising from ECPA. 44 Fed. Reg. 18677 (Mar. 29, 1979) (Notice of Proposed Rulemaking). See note 79 *supra*, and text at note 88 *supra*. Front-end money may be used to finance 75 percent of project costs, up to a maximum of \$20 million per property. 10 C.F.R. §§ 212.78(a)(2), 212.78(c) (definitions of "allowed expense," "recoupable allowed expenses," and "tertiary incentive revenue"). The amount of the benefit was initially defined as the allowed price increase less any *ad valorem* and severance taxes. This definition was later amended also to exclude from the benefit the windfall profit tax attributable to the allowed price increase. 10 C.F.R. § 212.78(c) (definition of "tertiary incentive revenue"), 45 Fed. Reg. 40106 (June 13, 1980). By excluding severance taxes and the windfall profit tax from the definition of the front-end tertiary price benefit, greater amounts of oil could be sold at uncontrolled prices. See note 375 *infra*. Certain of the provisions of the front-end tertiary program were later revised. 46 Fed. Reg. 1246 (Jan. 5, 1981).

¹¹³ 10 C.F.R. § 212.72 (definitions of "average completion depth" and "average daily production," paragraph (d) of the definition of "base production control level," and definitions of "completion depth" and "marginal property"), 44 Fed. Reg. 22010 (Apr. 12, 1979). Price incentives for marginal properties had been considered since 1976. See 41 Fed. Reg. 18873 (May 7, 1976) (notice of proposed rulemaking); 43 Fed. Reg. 52186 (Nov. 8, 1978) (notice of proposed rulemaking). The concept of "marginal property" applied to all the wells on a particular property, rather than to any one well. A marginal property is a property whose *average* daily production during 1978 did not exceed the limits below for the corresponding *average* completion depth of all of the production wells on the property:

Average completion depth (in feet)	Average daily production (barrels per day)
at least 2,000, but less than 4,000	20 or less
at least 4,000, but less than 6,000	25 or less
at least 6,000, but less than 8,000	30 or less
at least 8,000	35 or less

See text and note at note 29 *supra*. Marginal oil was to be redefined as upper tier oil in two stages: (1) by defining the BPCL of a marginal property, as of June 1, 1979, as equal to 20 percent of 1978 production, and (2) by defining the BPCL of a marginal property, as of January 1, 1980, as equal to zero. The definition of marginal property was later amended retroactively to increase the average daily production limitation by five barrels per day for each additional 2,000 feet of average completion depth at or below 10,000 feet. 45 Fed. Reg. 47406 (July 14, 1980). Marginal properties were estimated to account for approximately 25 percent of all lower tier oil. Staff of the Joint Committee on Taxation, *Design of a Windfall Profit Tax* 18 (June 1, 1979) [hereinafter cited as *Design of a Windfall Profit Tax*]; Congressional Budget Office, *The Windfall Profits Tax: A Comparative Analysis of Two Bills* 76 (Nov. 1979) [hereinafter cited as *Comparative Analysis of Two Bills*].

released to the upper tier on January 1, 1980.¹¹⁴ Finally, on July 16, 1979, the President announced that "heavy oil," "a highly viscous, almost tar-like crude, which must be heated to be produced,"¹¹⁵ would also be decontrolled.¹¹⁶

Lower and upper tier oil were to be phased out generally beginning on January 1, 1980. In addition, certain regulatory modifications effective prior to that date would have the effect of reducing the amount of oil subject to the lower tier ceiling price. Producers of lower tier oil could elect an updated BPCL for any property.¹¹⁷ If the election was made, producers would be allowed to reduce the volume of oil they were required to sell as lower tier oil by 1½ percent for each month of 1979.¹¹⁸ Lower tier oil producers would also receive a

¹¹⁴ The second stage of the marginal oil price increase was delayed by the President for three months. Executive Order No. 12187, 45 Fed. Reg. 3 (Jan. 2, 1980) (indefinite postponement of second stage); Executive Order No. 12209, 45 Fed. Reg. 26311 (Apr. 18, 1980) (postponement limited to three months).

¹¹⁵ President's Energy Address Fact Sheet, pt. V, July 16, 1979, reprinted in 1 EN. MNGT (CCH) ¶ 776 [hereinafter *President's Energy Address Fact Sheet*]. "Much of this reserve is in California." *Id.* Heavy oil production is approximately 265,000 barrels per day. Of this amount, 110,000 barrels per day were classified as stripper oil, and, therefore, were already decontrolled; 15,000 barrels per day were classified as marginal oil, and would have followed the marginal oil decontrol plan; 60,000 barrels per day were classified as lower tier oil other than marginal oil; and 80,000 barrels per day were classified as upper tier oil. *Comparative Analysis of Two Bills, supra* note 113, at 76.

¹¹⁶ *President's Energy Address Fact Sheet, supra* note 115. Decontrol of heavy oil was implemented by Executive Order No. 12153, 44 Fed. Reg. 48949 (Aug. 21, 1979) ("heavy" defined as weighted average gravity of 16.0 degrees API for sales on or after August 17, 1979); Executive Order No. 12186, 44 Fed. Reg. 76477 (Dec. 27, 1979) ("heavy" redefined as weighted average gravity of 20.0 degrees API for sales on or after December 21, 1979); Executive Order No. 12189, 45 Fed. Reg. 3559 (Jan. 18, 1980) (redefinition not retroactive); 10 C.F.R. § 212.59, 45 Fed. Reg. 21206 (Apr. 1, 1980) (crude oil pricing regulations conformed to Executive Orders). Further refinements on the treatment of heavy oil have been proposed. 45 Fed. Reg. 42222 (June 23, 1980).

As with other categories of oil, the 1979 heavy oil rules represented the culmination of a process that had begun several years earlier. In enacting ECPA, Congress specifically directed that the additional crude oil pricing flexibility provided under § 122 of that Act was to be used to mitigate the California crude oil problem: "One of the factors which led this Committee to agree upon the amendment which removes the three percent limitation on price adjustments as a production incentive was the understanding that this flexibility be used by the Administrator to adjust prices for heavy California crude oil to more equitable levels." S. REP. NO. 94-119, 94th Cong., 2d Sess. 73 (1976). The response was 10 C.F.R. § 212.73(c), 41 Fed. Reg. 48324 (Nov. 3, 1976), which provided increases in the lower tier ceiling price for oil of higher density. The issue of gravity price differentials also had been considered in proceedings prior to ECPA. 40 Fed. Reg. 28637 (July 8, 1975) (Notice of Proposed Rulemaking), withdrawn by 40 Fed. Reg. 54263 (Nov. 21, 1975); 41 Fed. Reg. 1564 (Jan. 6, 1976); 41 Fed. Reg. 4939-40 (Feb. 3, 1976).

¹¹⁷ The new BPCL for any property would be effective as of January 1, 1979, and would be the average monthly production of lower tier oil from the property for the six-month period ending March 31, 1979. 10 C.F.R. § 212.72 (paragraph (c)(1) of the definition of "base production control level"), 44 Fed. Reg. 22010 (Apr. 12, 1979).

¹¹⁸ This rate was said to be equal to the natural decline rate experienced for lower tier wells in 1978. *April, 1979 Fact Sheet, supra* note 102, at 10. The first adjustment under the 1½ percent decline rate would be made as of June 1, 1979, but would be calculated as if the new rate had become effective on January 1, 1979. 10 C.F.R. § 212.76(a)(3)(i), 44 Fed. Reg. 22010, 22016 (Apr. 12, 1979). Thus, if the election was made, the BPCL for a property would be reduced by

one-time forgiveness of cumulative deficiencies.¹¹⁹ Finally, effective January 1, 1980, the quantity of oil required to be sold as lower tier oil could be reduced by three percent per month.¹²⁰ The overall effect of these changes would be gradually to phase out lower tier oil so that, by October 1, 1981, the date price controls would terminate, most lower tier oil would already have been decontrolled. Upper tier oil would also be decontrolled, beginning on January 1, 1980, by gradually increasing the amount of upper tier oil which was decontrolled so that the world price for all upper tier oil was reached by October 1, 1981.¹²¹

Thus, by administrative action, President Carter directed the adoption of regulatory changes designed gradually to decontrol oil prices. New categories of oil were defined and given special price control treatment, including newly discovered oil, incremental tertiary oil, marginal oil, heavy oil, and front-end

nine percent (1½ percent per month multiplied by six months) as of June 1, 1979. 44 Fed. Reg. 22010, 22012 (Apr. 12, 1979).

¹¹⁹ 10 C.F.R. § 212.72 (paragraph (c) of the definition of "current cumulative deficiency"), 44 Fed. Reg. 22010, 22016 (Apr. 12, 1979).

¹²⁰ 10 C.F.R. § 212.76(a)(3)(ii), 44 Fed. Reg. 22010, 22016 (Apr. 12, 1979). The three-percent decline rate was available regardless of whether a revised BPCL was elected, and, as a consequence, regardless of whether the 1½ percent decline rate was adopted. Moreover, as of January 1, 1980, the BPCL for a property for which the 1½ percent decline rate was not elected could, nonetheless, be reduced by 18 percent, the aggregate reduction for electing properties for 1979.

¹²¹ 10 C.F.R. §§ 212.72 (definition of "market level new crude oil"), 212.74(a), 44 Fed. Reg. 66186, 66187-88 (Nov. 19, 1979). The President informed Congress that upper tier crude oil would be decontrolled by gradually increasing the controlled price: "Beginning on January 1, 1980, the upper tier oil price will increase in equal monthly increments until it reaches the world price on October 1, 1981." *President's April, 1979 Energy Message, supra* note 102, at 723. The Department of Energy did not find itself constrained, however, by the President's message. Its Notice of Proposed Rulemaking to implement decontrol of upper tier oil followed volumetric decontrol rather than gradual price increases. 44 Fed. Reg. 50605 (Aug. 29, 1979). No reference was made in the Notice to the President's statement. DOE's proposal was adopted unchanged: a percentage, beginning with 4.6 percent in January, 1980, and increasing by 4.6 percentage points each month thereafter, of crude oil that would otherwise be subject to upper tier ceiling prices would instead receive market prices. The choice of decontrol method was explained as follows:

We believe that a gradual decrease in the volume of crude oil subject to price controls would be simpler and surer; would ease industry's transition to the rigors of unregulated dealings; and would involve less administrative burden than ceiling price adjustments, particularly in view of the uncertainty as to what world market prices for crude oil will be on October 1, 1981. In addition, such action would permit the prices for first sales of an increasing amount of domestic crude oil to be determined by actual market factors without reference to the crude oil pricing regulations, and, thus, ease the transition to a market in which prices are determined solely by market factors. Finally, gradual release of increasing volumes of upper tier oil to market levels would not create an incentive to withhold production, as a gradual increase of upper tier prices to market levels might.

44 Fed. Reg. at 50605. It is important to recall that, each month, the amount of crude oil otherwise subject to upper tier ceiling prices would also include increasing amounts of decontrolled lower tier oil. Thus, not only was lower tier oil to be gradually released to the upper tier, but an increasing portion of such lower tier oil would, in effect, be released to market prices as upper tier oil was decontrolled.

tertiary oil. In addition, old oil would be phased out by reducing BPCLs, and new oil would be gradually decontrolled.¹²² All of these considerations and many others would become involved in the legislative process of developing a windfall profit tax, described below.

2. The Windfall Profit Tax

In addition to implementation of decontrol, the Administration proposed an excise tax on the domestic production of crude oil, to be effective on January 1, 1980.¹²³ It was stated that the tax would be borne by producers of crude oil because the marginal price of crude was set by imported oil, not domestic oil.¹²⁴ The tax would be imposed at a uniform rate of 50 percent, and would apply to two separate elements: producer revenues attributable to the decontrol of lower and upper tier oil, and producer revenues attributable to future OPEC price increases.¹²⁵ The principal reason given for imposing the tax was "equity." It

¹²² The Carter decontrol program continued until January 28, 1981. On that date, pursuant to the administrative authority delegated by EPAA, President Reagan signed an executive order decontrolling oil prices effective immediately. Executive Order No. 12287, 46 Fed. Reg. 9909 (Jan. 30, 1981). The reasons given for President Reagan's action were virtually identical to those cited by President Carter in support of phased decontrol:

For more than nine years, restrictive price controls have held U.S. oil production below its potential, artificially boosted energy consumption, aggravated our balance of payments problems, and stifled technological breakthroughs. Price controls have also made us more energy-dependent on the OPEC nations, a development that has jeopardized our economic security and undermined price stability at home.

* * *

This step will also stimulate energy conservation. At the same time, the elimination of price controls will end the entitlements system, which has been in reality a subsidy for the importation of foreign oil.

Statement on Signing Executive Order 12287, 17 WEEKLY COMP. OF PRES. DOC. 53 (Jan. 28, 1981); compare text at note 105 *supra*. Pursuant to the President's action, virtually all of the crude oil price regulations were made unnecessary, and, therefore, were revoked. 46 Fed. Reg. 20508 (Apr. 3, 1981).

President Reagan's action was expected to increase gross industry revenues by \$5 billion to \$13 billion, and to increase federal tax revenues, mostly through the windfall profit tax, by \$3.5 billion to \$8 billion. OIL & GAS J., Feb. 2, 1981, at 25-27. It was estimated that at the time of President Reagan's action, only 25 percent of U.S. oil production, comprising 15 percent of U.S. refinery input, remained subject to price controls. Fact Sheet, Decontrol of Crude Oil and Refined Petroleum Products, reprinted in DAILY TAX REP. (BNA), Jan. 28, 1981, at J-7.

The validity of President Reagan's decontrol order was challenged by a lawsuit alleging violations of the procedural requirements of the Administrative Procedure Act, the Economic Stabilization Act of 1970, and the Department of Energy Organization Act. The plaintiffs sought a preliminary injunction to halt enforcement of Executive Order No. 12287. The district court denied the motion for a preliminary injunction, noting the insubstantial likelihood that the plaintiffs would succeed on the merits. *Metzenbaum v. Edwards*, Civ. No. 81-0405 (D.D.C. Mar. 4, 1981). In addition, an amendment voiding President Reagan's decontrol order was defeated in the Senate, 68 to 24. 127 CONG. REC. S1952-63 (daily ed. Mar. 10, 1981).

¹²³ See sources cited at note 102 *supra*.

¹²⁴ 125 CONG. REC. H2675 (daily ed.) (remarks of Rep. Ullman). See text at note 34 *supra*.

¹²⁵ April, 1979 Fact Sheet, *supra* note 102, at 10.

would be unfair to permit domestic oil producers to retain all of the revenues attributable to decontrol and future OPEC price increases.¹²⁶

a. General Structure

The windfall profit tax was to be an "excise tax . . . imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period."¹²⁷ The amount of the tax would be 50 percent¹²⁸ of the windfall profit, determined with respect to each barrel of taxable crude oil.¹²⁹ The tax base was labeled the "windfall profit," and was defined as the excess of the "removal price" — generally, the sales price —¹³⁰ of the barrel of oil over the "adjusted base price" of such barrel.¹³¹ The windfall profit could not exceed the "net income" attributable to each barrel, determined by reference to percentage depletion concepts.¹³² The adjusted base price consisted of a base price derived from the crude oil price regulations as of May, 1979, adjusted for

¹²⁶ "As Government controls end, prices will go up on oil which has already been discovered, and unless we tax the oil companies, they will reap huge and undeserved windfall profits." *President's April, 1979 Energy Address*, *supra* note 102, at 610. "But decontrol could also further inflate the already enormous profits of the oil companies. As I've said, part of this excessive new profit will be totally unearned — what is called a 'windfall' profit." *President's April, 1979 Energy Address*, *supra* note 102, at 611. "This windfall profits tax protects against two areas of excessive producer revenues: those which may result from the future actions of the OPEC cartel; and those which will result from the lifting of price controls on ordinary lower and upper tier oil which does not qualify for special production incentives." *April, 1979 Fact Sheet*, *supra* note 102, at 10. See also *President's April, 1979 Energy Message*, *supra* note 102, at 721, 722; *Ways and Means Committee Hearings*, *supra* note 102, at 16 (statement of Treasury Secretary Blumenthal).

¹²⁷ Section 2(a)(1) of the *Ullman Bill*, *supra* note 102, adding new I.R.C. § 4986(a). [Hereafter, references to bill sections will be dropped. Instead, section references will be only to proposed sections of the Internal Revenue Code, unless otherwise indicated.] The Ullman Bill labeled the tax base as the "windfall profit," and, as a result, referred to the proposed excise tax as the "windfall profit tax." Since the Ullman Bill nomenclature was adopted by the Congress, the tax is referred to herein as the "windfall profit tax."

¹²⁸ The 50 percent rate was selected to allow for errors in estimating the impact of inflation, for delays in revising base prices to reflect inflation, and for royalties and severance taxes.

¹²⁹ *Ullman Bill*, *supra* note 102, § 4987(a). The per barrel computation could be significant in certain cases. If the base price exceeded the sales price on one barrel, the difference would not offset the excess of sales price over base price on another barrel.

¹³⁰ *Ullman Bill*, *supra* note 102, § 4989(c). Special constructive sales price rules were provided for sales between related persons, removal of oil from the premises before sale, and refining begun on the premises.

¹³¹ *Ullman Bill*, *supra* note 102, § 4989(a). Consideration was given to other formulations of the tax. For example, the tax base could instead be the increase in profits, earnings, or net income attributable to some factor such as increases in controlled prices. This approach, however, required a satisfactory, simple means of measuring the "excess" profit. Another alternative was to adopt a severance tax structure, and impose a flat-rate tax either on the total sales proceeds or on a per-unit basis. Under this approach, the tax base would clearly not correlate to decontrol or future OPEC price increases. See also text at note 175 *infra*, and note 399 *infra*.

¹³² *Ullman Bill*, *supra* note 102, § 4989(b). The Administration proposal did not include a net income limitation because it had been concluded that the 50 percent tax rate provided adequate protection against imposing a tax in excess of the actual income derived from the barrel of oil. In addition, the Administration proposal provided special treatment for certain potentially high-cost categories of oil: Stripper oil and incremental tertiary oil were to be taxed using the

inflation.¹³³ The holder of the economic interest with respect to the oil was required to pay the tax.¹³⁴

Under the Administration's proposal and the Ullman Bill,¹³⁵ distinctions among categories of oil were generally made through the definition and computation of base price. The base price was determined with respect to three "tiers" of oil corresponding, roughly, to lower tier oil, upper tier oil, and decontrolled oil. The base prices for Tiers 1, 2, and 3 were, at the time, approximately \$6, \$13, and \$16 per barrel, respectively, and the price for uncontrolled oil was in excess of \$16 per barrel. Thus, under Tier 1, a barrel of decontrolled lower tier oil sold at the upper tier ceiling price had a potential windfall profit of \$7 (\$13 minus \$6), and tax of \$3.50; if sold at the market price, the windfall profit would be \$10 (\$16 minus \$6), with a \$5 tax. If, however, the barrel of decontrolled lower tier oil were taxed as Tier 2 oil, the windfall profit would be zero if sold at the upper tier price, and \$3 if sold at the market price. Accordingly, "tier" classification carried with it substantial tax consequences.

b. Tier 1

The Administration proposed to use the lower tier base price to tax *only* the amount of lower tier oil that was decontrolled by the three-percent decontrol

most favorable base price, and marginal oil was to be taxed using the upper tier, rather than lower tier, base price. The Administration did not, however, seek to delete the net income limitation.

¹³³ *Ullman Bill*, *supra* note 102, § 4990. Thus, the base prices for the tax reflected regulated prices at the time of the windfall profit tax proposal. As sales prices increased due to either decontrol or future OPEC price increases, the tax base would increase accordingly, but would be reduced for inflation. This formulation of the tax followed earlier windfall profits tax proposals. See note 3 *supra*.

Since regulated prices were adjusted for inflation, if the base prices for tax purposes were left unadjusted, the tax base would accrue an element clearly unrelated to decontrol. Thus, to reconstruct in part what the applicable base price would have been under price controls, the base price needed to be adjusted for inflation. The measure of inflation was the gross national product (GNP) implicit price deflator, lagged by two calendar quarters to allow for the information to become available. The base for lower and upper tier oil would be the last quarter of 1978; for decontrolled oil, the base would be the second quarter of 1979. Thus, in the first quarter of 1980, when the tax was proposed to begin, the inflation adjustment for lower and upper tier oil would be the percentage by which the GNP deflator for the third quarter of 1979 (the latest available information) exceeded the deflator for the last quarter of 1978. This system is similar to that used in the energy regulations. See *President's April, 1979 Energy Message*, *supra* note 102, at 724, 725. The later base quarter for uncontrolled oil reflects the choice of a December, 1978, rather than May, 1979, base price for that part of the tax. See text at notes 157-58 *infra*.

¹³⁴ *Ullman Bill*, *supra* note 102, §§ 4986(b) and 4991(a)(1). The Ullman Bill provided one exception to the general rule imposing the tax on the holder of the economic interest in the crude oil. In the case of production payments dischargeable in specific dollar amounts, rather than a fixed volume of oil, the tax would be imposed on the holder of the economic interest from which the payment was created. *Ullman Bill*, *supra* note 102, § 4991(a)(2). "In these cases, the windfall from higher prices really is received by the owner of the residual interest in the oil, not the holder of the production payment, because the payment can be worked off with fewer barrels of oil owing to the higher price." WAYS AND MEANS REPORT, *infra* note 171, at 40.

¹³⁵ See note 102 *supra*.

decline rate¹³⁶ in excess of a two-percent decline rate.¹³⁷ As explained by Treasury Secretary Blumenthal:

The decontrol plan uses a 3 percent decline rate while the windfall profits tax uses a 2 percent rate. The difference is dictated by economics. As I noted above, a 3 percent decontrol decline rate was required to provide the incentive of replacement cost pricing for old oil properties and also to allow for a smooth transition to complete decontrol in 1981. Had a lower decline rate been employed, the "gap" when complete decontrol is required in 1981 would have been larger and the inflationary shock in 1982 greater.

However, the 3 percent decline rate exceeds the actual decline rate observed in almost every oil field. Thus, a 2 percent decline rate was selected for tax purposes as being closer to historical experience. Using a lower decline rate than 2 percent for tax purposes would obviously increase the amount of old oil subject to tax, but would risk discouraging production to some extent. The 2 percent decline for tax purposes represents a reasonable balance between capturing windfalls and assuring maximum production.¹³⁸

The two-percent decline rate for windfall profit tax purposes would begin on January 1, 1980, and continue past the expiration of price controls on September 30, 1981. Thus, by the end of May, 1983, the tax base attributable solely to the decontrol of lower tier oil was to be eliminated.¹³⁹

In order to implement this policy, the base price for Tier 1 oil was defined as the lower tier ceiling price as of May, 1979, determined under the March, 1979, energy regulations.¹⁴⁰ Tier 1 oil was defined in two parts: (1) oil that is or would be subject to the lower tier ceiling price rule of the June, 1979, energy regulations,¹⁴¹ and (2) oil that would be subject to the lower tier ceiling price rule of the June, 1979, energy regulations if the energy regulation decline rate

¹³⁶ See text at note 120 *supra*.

¹³⁷ *President's April, 1979 Energy Message*, *supra* note 102, at 724; *Ways and Means Committee Hearings*, *supra* note 102, at 17; *Ullman Bill*, *supra* note 102, § 4988(b).

¹³⁸ *Ways and Means Committee Hearings*, *supra* note 102, at 18.

¹³⁹ See *President's April, 1979 Energy Message*, *supra* note 102, at 724.

¹⁴⁰ *Ullman Bill*, *supra* note 102, § 4990(c). The effect of this rule is to select a unique price determined by the energy regulations, which price then becomes a part of the tax law, to be adjusted (if at all) through the tax law, not the energy regulations.

¹⁴¹ *Ullman Bill*, *supra* note 102, §§ 4988(b)(1) and 4988(e)(1). If the oil "is" subject to the June, 1979, lower tier ceiling price, a windfall profit would arise only if the price control inflation adjustment is more generous than the windfall profit tax inflation adjustment. The Ways and Means Committee indicated its expectation that the Department of Energy would adjust lower tier ceiling prices so that oil subject to the lower tier ceiling price would not be subject to the windfall profit tax. *WAYS AND MEANS REPORT*, *infra* note 171, at 18. By including in Tier 1 oil which "would be" subject to the June, 1979, lower tier ceiling price, oil released due to subsequent lower tier decontrol regulatory action would not escape the lower tier windfall profit tax base price unless the tax was amended, thus "freezing" the status quo.

were two percent instead of three percent.¹⁴² Thus, the tax base corresponding to lower tier oil would start with the June, 1979, energy regulations, and *add back* to the lower tier the difference between using a two-percent and a three-percent decline rate. The effect would be to subject only that difference to a windfall profit tax computed with the lower tier ceiling price¹⁴³ as the base price. All other lower tier oil decontrolled by the President in April, 1979, would escape the \$6 base price, including marginal oil,¹⁴⁴ front-end tertiary oil,¹⁴⁵ and oil released to the upper tier because of the election of a new BPCL¹⁴⁶ and elimination of cumulative deficiencies.¹⁴⁷ In addition, oil from stripper wells¹⁴⁸ and incremental tertiary production¹⁴⁹ were not included in the Tier 1 tax base.

c. Tier 2

The windfall profit tax using the upper tier base price would apply to all oil that is or would be subject to the upper tier ceiling price rule of the June, 1979, energy regulations,¹⁵⁰ except for oil taxed in Tier 1. The upper tier base price would be determined as of May, 1979, using the March, 1979, energy regulations.¹⁵¹ Since the Tier 1 tax base was defined narrowly, much of the oil subject to price controls as of April, 1979, would be taxed using the Tier 2 base price. Thus, the Tier 2 base price would apply to pre-decontrol upper tier oil, marginal oil, front-end tertiary oil,¹⁵² oil released to the upper tier as a result of the BPCL and cumulative deficiency adjustments, and other decontrolled lower tier oil, except oil included in Tier 1. The Tier 2 tax base did not include stripper oil, newly discovered oil, or incremental tertiary oil.

Upper tier oil was to be decontrolled gradually by October 1, 1981.¹⁵³ Thus, by that date, the sales price for upper tier oil would be the market price,

¹⁴² *Ullman Bill*, *supra* note 102, § 4988(b)(2).

¹⁴³ The lower tier ceiling price was, on average, approximately \$6 per barrel as of May, 1979.

¹⁴⁴ See note 113 *supra*.

¹⁴⁵ See note 112 *supra*. Treatment of front-end tertiary oil was unclear. The Administration stated that "[t]he lower tier taxable volume will not include . . . production that is released beginning on January 1, 1980, in order to finance investment in tertiary recovery." *President's April, 1979 Energy Message*, *supra* note 102, at 725. The Ullman Bill, however, which purported to embody the Administration's proposal, is described as making "no special provision for [front-end tertiary] oil on the theory that DOE would provide enough 'up front' money through the pricing structure and would take into account the fact that additional price increase would be subject to tax." *Design of a Windfall Profit Tax*, *supra* note 113, at 26.

¹⁴⁶ See notes 117-18 *supra*.

¹⁴⁷ See note 119 *supra*.

¹⁴⁸ See text at notes 49-51, 59-60 *supra*.

¹⁴⁹ See note 111 *supra*.

¹⁵⁰ *Ullman Bill*, *supra* note 102, §§ 4988(c) and 4988(e)(2).

¹⁵¹ *Ullman Bill*, *supra* note 102, § 4990(d)(1).

¹⁵² But see note 145 *supra*.

¹⁵³ Decontrol was to be accomplished by increasing the ceiling price. Instead, decontrol was implemented by increasing the volume of upper tier oil that is decontrolled. See note 121 *supra*.

while the windfall profit tax base price would be \$13, adjusted for inflation. The Tier 2 tax was to phase out between November, 1986, and December, 1990, by increasing the upper tier base price to the Tier 3 base price in accordance with a schedule to be prescribed by the Treasury Department.¹⁵⁴ Thus, by 1991, that portion of the tax base attributable solely to the decontrol of upper tier oil was to be eliminated. This decision was explained as follows:

The upper-tier tax is phased out in order to simplify the windfall profits tax at a point in time when fine distinctions are no longer needed. Computing the upper-tier requires reference to the last vestiges of price controls. Since revenue from the upper-tier tax will decrease substantially after 1985 as the volume of upper-tier oil diminishes, we decided to phase out the upper-tier tax after 1986.¹⁵⁵

Thus, by 1991 only the Tier 3 base price would remain.

d. Tier 3

The Tier 3 tax base reflected the objective of taxing windfall profits attributable to future OPEC price increases.¹⁵⁶ The Tier 3 base price was set, therefore, at \$16 per barrel,¹⁵⁷ the estimated prevailing price as a result of December, 1978, OPEC price increases.¹⁵⁸ The Tier 3 tax base included all

¹⁵⁴ *President's April, 1979 Energy Message*, *supra* note 102, at 725; *Ullman Bill*, *supra* note 102, § 4990(d)(2).

¹⁵⁵ *Ways and Means Committee Hearings*, *supra* note 102, at 18 (statement of Treasury Secretary Blumenthal).

¹⁵⁶ See note 126 *supra*.

¹⁵⁷ The Administration proposed a flat \$16 per barrel Tier 3 base price, regardless of quality or location or other factors. *President's April, 1979 Energy Message*, *supra* note 102, at 725. The Administration's proposal would have been easy to administer, and would have provided an additional incentive for lower-priced crudes, such as heavy oil. It would have led, however, to situations in which high quality oil selling above \$16 was taxed too much, and low quality oil selling below \$16, too little, on the assumption that profits attributable only to future OPEC price increases were to be taxed. The Ullman Bill, by contrast, required the Treasury Department to assume an *average* price of \$16 per barrel in December, 1979, and then to publish regulations that provided a method for determining the price for which oil of a particular grade and location would have sold. *Ullman Bill*, *supra* note 102, § 4990(e).

¹⁵⁸ *President's April, 1979 Energy Message*, *supra* note 102, at 725; *Ullman Bill*, *supra* note 102, § 4990(e). The selection of the \$16 base price was discussed by Treasury Secretary Blumenthal:

A number of questions have been raised concerning the \$16 per barrel base price for the uncontrolled tier tax. The \$16 figure is based on the estimated world price which would be in effect as of the first quarter of 1980 as a result of the December, 1978, OPEC price announcement. The base price was calculated to allow for uncertainties about the difference between the posted price of Saudi Arabian marker crude, and transportation costs, quality differentials and other relevant factors. By choosing \$16, most domestically produced uncontrolled crude oil would pay no tax unless OPEC were to raise its prices in excess of inflation.

Second, it has been suggested that the \$16 base be increased because recent OPEC surcharges have already increased the price of oil. However, the President's windfall profits tax proposal is designed to prevent domestic producers from

domestic crude oil that was not included in Tier 1 or Tier 2, except Alaskan North Slope oil.¹⁵⁹ Tier 3 oil initially would include, therefore, newly discovered oil,¹⁶⁰ incremental tertiary oil,¹⁶¹ and stripper oil.¹⁶² ANS oil was excluded because, at the time of the proposal, the wellhead price of ANS oil was substantially below the base price for tax purposes.¹⁶³

Although, when proposed, the Tier 3 tax covered less than one-third of domestic oil production, the Tier 3 tax would eventually include all domestic oil production, other than ANS oil, as Tier 1 phased into Tier 2¹⁶⁴ and Tier 2 phased into Tier 3.¹⁶⁵ At such time, the entire windfall profit tax base would be limited to the amount, if any, by which OPEC price increases after December, 1978, had outstripped inflation. In addition, the Tier 3 tax was to be permanent. This controversial feature was addressed at length by Secretary Blumenthal:

[I]t has been argued that since the tax on the uncontrolled oil tier is permanent, the United States is permanently condemning producers to a lower price at home than they might realize abroad, and that the United States will produce less oil than would be produced in the absence of a permanent tax.

benefiting from just these kinds of sudden price increases. There is no rational reason for exempting the profits domestic producers are realizing from these surcharges from the windfall profits tax.

Ways and Means Committee Hearings, supra note 102, at 19.

¹⁵⁹ The exemption for ANS oil was implemented by excluding from the definition of "taxable crude oil" "any crude oil produced from a well north of the Arctic Circle." *Ullman Bill, supra* note 102, §§ 4988(a) and 4991(b)(6).

¹⁶⁰ See note 110 *supra*.

¹⁶¹ See note 111 *supra*.

¹⁶² See text at notes 49-51, 59-60 *supra*. Tier 3 also included production from the Naval Petroleum Reserve, which was exempt from crude oil price controls, 10 C.F.R. § 212.55, and production from "various other Federal enclaves," *WAYS AND MEANS REPORT, infra*, note 171, at 22 n.3. Since production from these sources is quite small, their treatment under the windfall profit tax will not be discussed further herein.

¹⁶³ See § I.B.4.a. *supra*. As explained by the Treasury Department:

The exemption of Alaskan North Slope oil is based on the economies of Alaskan production. According to the most recent DOE data, the average wellhead price of Alaskan crude was only \$5.40 a barrel, due to the extraordinarily high transportation costs which must be incurred to bring this production to market. While this wellhead price will rise dollar-for-dollar with increases in the world price of oil, it would not reach \$16 per barrel until the wellhead price of Saudi Arabian marker crude reaches \$22 a barrel (in 1980 prices). Although prices of imported oil have been increasing rapidly over the last few months, we will not likely see posted prices at the \$22 level in the near future. It is easier to exempt Alaskan production from the tax than to require Alaskan producers to file tax returns solely for the purpose of showing that no liability has been incurred.

Ways and Means Committee Hearings, supra note 102, at 19. The \$22 figure was reached before the end of 1979.

¹⁶⁴ By June 1, 1983.

¹⁶⁵ By January 1, 1991.

The world price of oil has major noncompetitive aspects. Since 1973, it has been set well above the cost of production by a cartel. Given these circumstances, there is no economic reason for allowing domestic producers to receive the world price of oil on their production.

Moreover, it is simply not true that producers can earn even more abroad than they can at home if the uncontrolled tier tax is enacted. In every other producing country, increases in the price of oil have immediately been accompanied by increases in taxes on producers or by nationalization. Either action deprives the producers of the increased revenues. Even in the U.K., the tax on North Sea producers is designed to make the government the principal beneficiary of higher world oil prices. This same effect has been realized in Venezuela through nationalization. Similar examples can be found in most other countries.

Finally, those who argue that we will lose a small amount of domestic production due to the uncontrolled tier tax fail to recognize the risk of imposing no tax at all. Political forces will not allow complete and permanent decontrol of oil so long as we face an unqualified threat of embargoes and sudden price increases. In the absence of a permanent tax, a future surge in oil prices may compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation. By imposing a permanent tax with a base which is adjusted for inflation, I believe we will, in the long run, allow producers to receive approximately the same price as is received outside the U.S. but with standby protection that will prevent them from receiving sudden windfall profits due to increases in prices as a result of anti-competitive cartel practices.¹⁶⁶

Thus, despite the resulting loss of production, the Administration committed itself to a permanent tax on domestic crude oil, in order to reduce the risk of having price controls reimposed on oil at some future date.

¹⁶⁶ *Ways and Means Committee Hearings*, *supra* note 102, at 19. The detail and emphasis of the Secretary's statement were understandable. The tax was premised on the need to limit "windfalls" (presumably, economic rents) attributable to decontrol and to future OPEC price increases. Windfalls, however, dissipate over time as the market adjusts to new price levels, and higher prices encourage greater risks to be assumed in development and production. See note 19 *supra*, note 313 *infra*. Consequently, the justification for a permanent tax, unless required to raise revenue, was questionable. Note that the tax bases attributable solely to decontrolling lower and upper tier oil would phase out by June 1, 1983, and January 1, 1991, respectively. Thereafter, the tax base would be attributable solely to post-December, 1978, OPEC price increases in excess of inflation.

e. *Other Provisions*¹⁶⁷

Two additional provisions in the Administration proposal merit mention. First, the Administration proposed to delete the amount of the windfall profit from gross income for purposes of computing the percentage depletion deduction.¹⁶⁸ This proposal was premised on the argument that if a portion of gross income was sufficiently a windfall to merit imposition of the windfall profit tax, such portion ought not, at the same time, provide the basis for a tax subsidy. Second, the windfall profit tax would generally be deductible for federal income tax purposes as a business expense.¹⁶⁹ The Ullman Bill provides a federal income tax deduction as a tax.¹⁷⁰

Thus, the Carter Administration presented Congress with a windfall profit tax proposal for a permanent 50 percent excise tax applied to a tax base consisting of the difference between the amount received for the oil, and a base price derived from the price control regulations. The tax base could not exceed net income. Special treatment was accorded to marginal oil, Alaskan oil, newly discovered oil, incremental tertiary oil, and stripper oil. In addition, the base for the percentage depletion allowance would be reduced by the amount of the windfall profit. The need for, and basic structure of, the Administration's proposed tax would be accepted throughout the ensuing congressional review. Considerable attention would be devoted, however, to the detailed provisions.

B. *The Ways and Means Committee Bill*

1. In General

On June 22, 1979, the House Ways and Means Committee reported out a windfall profit tax bill.¹⁷¹ The Ways and Means Bill followed the basic struc-

¹⁶⁷ One provision was notable by its absence. A major issue in prior windfall profits tax proposals and in the crude oil equalization tax proposal, note 3 *supra*, was whether the tax base (or, alternatively, the tax) should be reduced by reason of certain energy-related investments, a reduction popularly known as "plowback." Plowback could be viewed either as a further tax incentive for production, or as a means to dilute the tax. If the object of decontrol, insofar as producers were concerned, was to present them with production incentives through market prices, and if the purpose of the tax was to absorb "windfalls," then there was no need for plowback as an incentive. Although not ultimately adopted, plowback played (and continues to have) an important role in consideration of the windfall profit tax. See text at notes 230 and 241 and notes 323 and 393 *infra*.

¹⁶⁸ *President's April, 1979 Energy Message, supra* note 102, at 725; § 2(b) of the *Ullman Bill, supra* note 102, amending I.R.C. § 613(a).

¹⁶⁹ See Treas. Reg. § 1.164-2(f); *President's April, 1979 Energy Message, supra* note 102, at 723.

¹⁷⁰ Section 2(b)(1) of the *Ullman Bill, supra* note 102, adding new I.R.C. § 164(a)(5). The Ullman Bill provision was eventually enacted by § 101(b) of the Crude Oil Windfall Profit Tax Act of 1980. For the proper timing of a deduction of the windfall profit tax by a cash basis taxpayer, see Rev. Rul. 81-99, I.R.B. 1981-13, 32.

¹⁷¹ H.R. 96-3919, 96th Cong., 1st Sess. (June 22, 1979) [hereinafter cited as *Ways and Means Bill*]; H.R. REP. NO. 96-304, 96th Cong., 1st Sess. (June 22, 1979) [hereinafter cited as *WAYS AND MEANS REPORT*].

ture of the tax, and its relationship to crude oil price controls, as proposed by the Administration and introduced in the Ullman Bill. The Ways and Means Bill, however, attempted to identify and subject to tax more of the windfall revenues attributable to decontrol. The general effect of changes adopted by the Ways and Means Committee was to widen the tax base and increase the tax rate while, at the same time, either minimizing the imposition of production disincentives or providing production incentives where appropriate. The Ways and Means Committee generally adopted the Administration's rationale for the tax:

For most types of oil, after a certain point, these higher [domestic oil] prices will only lead to very limited increases in production. The revenues resulting from these higher prices, however, would provide income to oil producers far in excess of what most of them originally anticipated when they drilled their wells and in excess of what they might now be expected to invest in energy production. Indeed, some producers are now using their excess revenues to acquire unrelated businesses.

Thus, the committee believes that the additional revenues received by oil producers and royalty owners, both as a result of decontrol of oil prices and as a result of increases in world oil prices substantially above those prevailing in 1978, are an appropriate object of taxation. The windfall profit tax in this bill will tax away a fair portion of these additional revenues while allowing producers to receive very high prices for those types of oil whose production can be expected to increase in response to that incentive.¹⁷²

The Committee specified its taxing strategy as follows:

The committee's windfall profit tax is carefully designed to impose relatively high tax rates where production cannot be expected to respond very much to further increases in price and relatively low tax rates on oil whose production is likely to be responsive to price. The lowest tax burden will be on newly discovered oil, incremental oil produced on properties using tertiary recovery techniques, and Alaskan oil. The highest tax burdens will be on old oil, which is oil discovered before 1973. The first tier of the tax, the tier applying to old oil, also is carefully structured so that increases in production will command a lighter tax burden, thus creating an incentive to increase production from old oil properties.¹⁷³

* * *

The Committee believes that a relatively heavy tax on tier one and tier two oil, along with more lenient treatment of newly discovered,

¹⁷² WAYS AND MEANS REPORT, *supra* note 171, at 7.

¹⁷³ *Id.*

Alaskan and tertiary oil, strikes the appropriate balance between revenue needs and production incentives.¹⁷⁴

Finally, the Committee noted that the tax would have to be absorbed by oil producers since imported oil sets the marginal price of domestic oil, and also pointed out that an excise tax was a "far simpler approach" to taxing windfalls than a true excess profits tax.¹⁷⁵ Thus, the objectives and structure of the Ways and Means Bill were similar to those of the Administration Bill. The Committee made significant changes, however, in the tax rate and the tax base.

2. General Structure

The Ways and Means Committee Bill increased the general rate of tax from 50 percent to 70 percent,¹⁷⁶ but allowed a deduction from the removal price for certain amounts of state severance taxes¹⁷⁷ and refined the net income limitation on the amount of windfall profit subject to tax.¹⁷⁸ The decision to impose a 70 percent tax rate may have necessitated adoption of the severance tax deduction in order to avoid combined tax rates approaching and beyond 100 percent.¹⁷⁹ No severance tax deduction was allowed, however, for that portion of the windfall profit that remained subject to the 50 percent rate of tax¹⁸⁰ since the Committee concluded that "undue burdens" were not created at the lower rate.¹⁸¹ Thus, in small part, the increase in tax rate was offset by the allowance of the severance tax deduction.¹⁸² For the most part, however, the rate increase meant that the federal government would simply recoup a greater share of the windfall profit tax base than the Administration had proposed. The severance tax adjustment was limited to the severance tax attributable to the windfall profit.¹⁸³ The severance tax adjustment was also limited to the severance tax

¹⁷⁴ *Id.* at 14.

¹⁷⁵ *Id.* at 7. Compare note 131 *supra*.

¹⁷⁶ *Ways and Means Bill, supra* note 171, § 4987(a). The Committee specifically rejected rates of 60, 65, and 85 percent. Daily Tax Rep. (BNA), June 14, 1979, at G-6. A 50 percent rate was allowed in certain narrow instances, discussed below. See text at notes 223 and 226 *infra*; *Ways and Means Bill, supra* note 171, §§ 4987(b), 4991(a)(2), and 4991(b)(1)(A).

¹⁷⁷ *Ways and Means Bill, supra* note 171, § 4989(a)(2).

¹⁷⁸ *Ways and Means Bill, supra* note 171, § 4989(b).

¹⁷⁹ "The severance tax adjustment is necessary to avoid placing an undue burden on the producer of oil when the combined effect of the 70 percent windfall profit tax rate, the severance tax, and State and Federal income taxes is taken into account." WAYS AND MEANS REPORT, *supra* note 171, at 35. See *Design of a Windfall Profit Tax, supra* note 113, at 12. Note that the allowance of a deduction for state severance taxes operates as a form of revenue sharing with respect to the windfall profit. See note 358 *infra*.

¹⁸⁰ Taxable Alaskan oil, *Ways and Means Bill, supra* note 171, § 4991(b)(1)(E), and the first \$9 of windfall profit of newly discovered oil were to be subject to a 50 percent tax rate.

¹⁸¹ WAYS AND MEANS REPORT, *supra* note 171, at 35.

¹⁸² "The same amount of revenue can be raised either by a 50 percent rate and no severance tax deduction or by a 53 percent tax rate and a deduction for increases in severance taxes." *Design of a Windfall Profit Tax, supra* note 113, at 12.

¹⁸³ *Ways and Means Bill, supra* note 171, § 4992(d)(1).

imposed by state law in effect on March 31, 1979,¹⁸⁴ in order "[t]o discourage States from raising severance taxes at the expense of the federal Treasury."¹⁸⁵

In addition to the severance tax deduction, excessive windfall profit tax burdens were also to be prevented by a net income limitation. The net income limitation started with the determination of taxable income from the property under existing percentage depletion law.¹⁸⁶ For this purpose, the term "property" followed the income tax rules, not the crude oil price rules.¹⁸⁷ Taxable income was then modified to eliminate any deduction for the windfall profit tax,¹⁸⁸ and to require that the computation of the depletion deduction be on an actual or deemed cost depletion basis.¹⁸⁹ Thus, intangible drilling expenses, other than dry-hole costs, were required to be capitalized and taken into account in computing cost depletion for this purpose.¹⁹⁰ In addition, taxable income was determined by including in gross income the income attributable to a production payment carved out of the property,¹⁹¹ and in order to prevent the use of property transfers to increase the cost depletion basis for the property and so avoid the windfall profit tax, post-1978 transfers of a proven oil or gas property increased basis only to the extent of costs incurred after the

¹⁸⁴ *Ways and Means Bill*, *supra* note 171, § 4992(d)(2).

¹⁸⁵ WAYS AND MEANS REPORT, *supra* note 171, at 35.

¹⁸⁶ I.R.C. § 613(a); Treas. Reg. § 1.613-5. Under § 613(a), the allowance for percentage depletion "shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion)." Thus, the § 613(a) computation limits a tax benefit, whereas the windfall profit tax net income rule limits a tax.

¹⁸⁷ Section 613(a) of the Internal Revenue Code is subject to the definition of property in § 614 of the Code: "the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land." "Property" is defined in the crude oil price regulations as "the right to produce domestic crude oil, which arises from a lease or from a fee interest." In addition, at the election of the producer, a separate and distinct producing reservoir, if recognized as such by the appropriate governmental agency, may be a property. 10 C.F.R. § 212.72 (1980) (definition of "property"). See also DOE Ruling 1975-15, 40 Fed. Reg. 40832 (Sept. 4, 1975); DOE Ruling 1977-1, 42 Fed. Reg. 3628 (Jan. 19, 1977); DOE Ruling 1977-2, 42 Fed. Reg. 4409 (Jan. 25, 1977); *Grigsby v. Doe*, 585 F.2d 1069 (TECA 1978), *cert. denied*, 440 U.S. 908 (1979); *Pennzoil v. Doe*, 4 EN. MNGT. (CCH) ¶ 26,305 (D. Del. 1981). Under the Ways and Means Bill, the federal income tax definition of property applies only for purposes of the net income limitation, and in reference to percentage depletion. WAYS AND MEANS REPORT, *supra* note 171, at 29. The price regulation definition of "property" applies for all other windfall profit tax purposes.

¹⁸⁸ *Ways and Means Bill*, *supra* note 171, § 4989(b)(3)(B)(iii).

¹⁸⁹ *Ways and Means Bill*, *supra* note 171, §§ 4989(b)(3)(B)(i) and (ii), 4989(b)(3)(C), and 4989(b)(3)(D).

¹⁹⁰ *Id.* Thus, the cost history of a particular property must be reconstructed historically in order to determine what the current cost depletion deduction would be. Cf. I.R.C. §§ 57(a)(8) and 57(a)(11).

¹⁹¹ *Ways and Means Bill*, *supra* note 171, § 4989(b)(5). Presumably, the committee meant to follow the definition of "production payment" in I.R.C. § 636. Including the gross income from the property attributable to the production payment in the producer's gross income is consistent with treating the production payment as a secured loan.

¹⁹² *Ways and Means Bill*, *supra* note 171, § 4989(b)(4). A property whose capitalized cost is low relative to its value might be subject to a stiff windfall profit tax, and, because of the low cost, receive no benefit from the net income limitation. A purchaser or lessee of all or a portion of the property would likely benefit from the net income limitation because the cost depletion basis

transfer.¹⁹² Thus, the Ways and Means Committee generally increased windfall profit tax burdens by increasing the tax rates, but provided some relief through the severance tax deduction and net income limitation. Furthermore, beyond these general changes, the Committee also modified the coverage of each of the three tiers.

3. Tier 1

The Ways and Means Committee broadened considerably the Tier 1 tax base. The Committee reduced the windfall profit tax decline rate from two percent to 1½ percent.¹⁹³ Thus, the volume of oil included in Tier 1 became the excess of oil decontrolled using the price control three-percent decline rate over what would have been decontrolled using a 1½ percent decline rate. In addition, the Ways and Means Bill included marginal oil in Tier 1,¹⁹⁴ because the Committee disagreed with the Administration's decision that a windfall profit tax incentive for marginal oil was justified.¹⁹⁵ This decision increased the Tier 1 tax base by approximately one-third beyond the Administration proposal.¹⁹⁶

4. Tier 2

Less significant changes were made in Tier 2. The Ways and Means Bill eliminated the phase-out of the Tier 2 tax base proposed by the Administration.¹⁹⁷ No explanation for this decision was given in the Ways and Means

would be high relative to value. Thus, the after-tax revenues could be much higher for the transferee than the transferor. See the example in WAYS AND MEANS REPORT, *supra* note 171, at 37-38.

¹⁹³ *Ways and Means Bill*, *supra* note 171, § 4988(b)(2). Although the Ways and Means Report is silent on why the 1½ percent Tier 1 decline was chosen, a possible explanation is provided in *Design of a Windfall Profit Tax*, *supra* note 113, at 16:

The 2-percent rate chosen by the Administration is faster than the natural decline rate of virtually all oil fields. It results in a narrow tier one tax base, which consists only of the gap between the 3-percent price control decline curve and the 2-percent tax decline curve. A slower statutory decline rate could increase the tax base significantly; however, if the statutory decline rate were reduced below about 1½ percent, there would be properties producing below their decline curves, and some producers would no longer be in a situation in which increments to production affect only the amount of oil subject to the more favorable tier two tax rate. As the decline rate is lowered below 1½ percent, this would be the situation with more and more properties. Thus, the tradeoff is between revenue and production incentives.

The Ways and Means Committee specifically rejected statutory decline rates for Tier 1 equal to 1¼ percent and to the property's actual historical decline curve as established between 1972 and 1974. Daily Tax Rep. (BNA), June 11, 1979, at G-7.

¹⁹⁴ *Ways and Means Bill*, *supra* note 171, § 4988(e)(3).

¹⁹⁵ In the view of the Committee, inclusion of a net income limitation on the amount of the windfall profit may have obviated the need for special treatment of marginal oil. See *Design of a Windfall Profit Tax*, *supra* note 113 ("... the provision in H. R. 3919 limiting the taxable windfall profit to net income from a property provides some relief for truly marginal properties where costs exceed price." *Id.* at 18; "[the net income limitation] is intended to relieve the tax burden on high cost properties. It could, in that sense, be considered as an alternative to establishing a special category under the tax for marginal properties." *Id.* at 29).

¹⁹⁶ See note 113, *supra*.

¹⁹⁷ Compare *Ways and Means Bill*, *supra* note 171, § 4990(d), with *Ullman Bill*, *supra* note 102, § 4990(d).

Report.¹⁹⁸ In addition, the Bill specified that oil released from the lower tier ceiling price to finance tertiary recovery projects would be taxed in Tier 2,¹⁹⁹ clearing up an earlier ambiguity.²⁰⁰

5. Tier 3

The Ways and Means Committee followed the Administration's proposal to tax stripper oil, newly discovered oil, and incremental tertiary oil in Tier 3. The Committee amended the definitions of newly discovered oil and incremental tertiary oil, however, and also decided to tax certain Alaskan oil in Tier 3. These decisions were generally consistent with the policy underlying Tier 3 to tax additional revenues attributable to future OPEC price increases.

a. Stripper Oil

The Committee adopted the Administration's proposal, but added a rule to ensure that post-1978 transfers of property could not be used to create additional stripper oil.²⁰¹

b. Incremental Tertiary Oil

The Administration's proposal and the Ullman Bill followed the classification resulting from the pricing regulations. The Ways and Means Bill, however, provided its own definition of incremental tertiary oil,²⁰² which differed significantly from the pricing rules. The pricing rules²⁰³ relied heavily on DOE certification, and limited the decontrol benefit to oil produced in excess of estimated production without the tertiary process. Instead, in a significant departure from the then existing DOE practices, the Ways and Means Committee adopted self-certification "to reduce delays in implementing tertiary recovery" and "to expedite the use of tertiary recovery methods."²⁰⁴ The Bill had six requirements for self-certification:²⁰⁵ (1) one of the approved tertiary recovery methods must be used; (2) application of the method must follow "sound engineering principles;" (3) application of the method must "reasonably be expected to result in a significant increase in the amount of crude oil

¹⁹⁸ The Administration's proposal to phase out Tier 2 by gradually raising the Tier 2 base price to the Tier 3 base price had been criticized by the staff of the Joint Committee on Taxation as providing an incentive to withhold production until the phase out was completed. *Design of a Windfall Profit Tax*, *supra* note 113, at 27. It was suggested that "[o]ne alternative to H.R. 3919 would be not to phase out the tier two tax at all, but instead to allow it to phase itself out as more and more of the nation's oil becomes newly discovered oil in tier three." *Id.* Apparently, the Ways and Means Committee followed this alternative.

¹⁹⁹ *Ways and Means Bill*, *supra* note 171, § 4991(d).

²⁰⁰ See note 145 *supra*.

²⁰¹ See note 219 *infra*.

²⁰² *Ways and Means Bill*, *supra* note 171, § 4991(c)(2).

²⁰³ See text at notes 79-88 *supra*.

²⁰⁴ WAYS AND MEANS REPORT, *supra* note 171, at 26.

²⁰⁵ *Ways and Means Bill*, *supra* note 171, §§ 4991(c)(4)(B) and 4991(c)(5).

which will ultimately be recovered;" (4) the project must be uneconomic without the special tax provision;²⁰⁶ (5) the project must begin after May, 1979; and (6) information confirming the foregoing, particularly a petroleum engineer's certification, must be submitted. A DOE-certified project qualified without resort to these separate tax criteria.²⁰⁷ The list of approved tertiary recovery methods followed the then-existing pricing regulations,²⁰⁸ with authorization given to the Secretary of the Treasury to add additional methods.²⁰⁹ A significant increase in recoverable oil was not considered reasonably expected if production was merely accelerated or if the costs of the project would not be covered.²¹⁰ The economic test was not explained further. Tax benefits commenced with the project beginning date.²¹¹ Qualification as a tertiary recovery project, and the attendant tax benefits, continued only so long as the DOE certification was in effect or the self-certified project continued to satisfy the applicable requirements.²¹²

In another departure from DOE rules, incremental measurement of oil produced by a tertiary recovery project was abandoned in favor of a uniform decline curve. A "base level" for the property was established equal to the average production during the six-month period ending on March 31, 1979, reduced by (1) one percent for each month beginning after 1978 and before the project beginning date; and (2) 2½ percent for each month thereafter and before the current month.²¹³ The amount of oil entitled to Tier 3 treatment as incremental tertiary oil was production from a property for which a qualified project was in effect in excess of the adjusted base level,²¹⁴ as contrasted with the pricing regulations' incremental approach.²¹⁵ Thus, for example, if a qualified project commenced on January 1, 1981, 24 percent of production from the property would immediately be treated as Tier 3 oil, and by July, 1983, if the

²⁰⁶ This criterion is quite similar to the price regulations' test. See text at note 85 *supra*.

²⁰⁷ *Ways and Means Bill*, *supra* note 171, § 4991(c)(4)(A).

²⁰⁸ *Ways and Means Bill*, *supra* note 171, § 4991(c)(6)(A)(i); 10 C.F.R. §§ 212.78(c)(1)-(9) (1980), 43 Fed. Reg. 33679 (Aug. 1, 1978).

²⁰⁹ *Ways and Means Bill*, *supra* note 171, § 4991(c)(6)(A)(ii).

²¹⁰ WAYS AND MEANS REPORT, *supra* note 171, at 25.

²¹¹ *Ways and Means Bill*, *supra* note 171, §§ 4991(c)(2)(A)(i) and 4991(c)(6)(B).

²¹² *Ways and Means Bill*, *supra* note 171, §§ 4991(c)(4)(A) and 4991(c)(5)(D)(i).

²¹³ *Ways and Means Bill*, *supra* note 171, § 4991(c)(2)(B).

²¹⁴ *Ways and Means Bill*, *supra* note 171, § 4991(c)(2)(A). The Committee rejected a proposal to exempt all existing oil from a field where tertiary production is used. *Washington Post*, June 13, 1979, at C2, col. 5. For DOE-certified projects, the amount of incremental tertiary oil cannot be less than the price regulation amount. *Ways and Means Bill*, *supra* note 171, § 4991(c)(2)(C). To determine the classification of remaining production, incremental production is allocated pro rata as between production that would have been Tier 1 and Tier 2 oil without the incremental tertiary provision. *Ways and Means Bill*, *supra* note 171, § 4991(c)(3)(A). The determination within a tier of which barrels have been released to Tier 3 is made by selecting the barrels with the highest removal prices first. *Ways and Means Bill*, *supra* note 171, § 4991(c)(3)(B).

²¹⁵ See text at note 83 *supra*. Although the Ways and Means Committee did not explain why it rejected the incremental approach to classifying production from tertiary projects, the staff of the Joint Committee on Taxation ascribed "administrative problems" to this approach: "No

project continued, all of the production from the property would be classified as Tier 3 oil.

c. *Newly Discovered Oil*

The Ways and Means Committee found the pricing regulations' definition of newly discovered oil too generous, and, therefore, wrote its own, narrower definition. In addition, the Committee decided to provide preferential treatment to newly discovered oil by means of the base price, tax rate, and inflation adjustment.

The pricing regulations defining newly discovered oil required only that there be no production from the property during 1978.²¹⁶ Thus, production from shut-in or abandoned properties, and production from "old" discoveries that had not yet been commercialized, qualified as newly discovered oil. The Ways and Means Committee decided instead that "newly discovered" should have a more literal meaning for tax purposes. Consequently, the Committee required that there be no production in commercial quantities from the property after 1969 and before 1979.²¹⁷ The Committee also excluded from newly discovered oil production from a reservoir penetrated by a well after 1969 and before 1979, if crude oil could have been produced through the well before 1979.²¹⁸ Finally, the Committee sought to prevent properties from being subdivided to "create" newly discovered oil.²¹⁹

Having refined the definition, the Committee proceeded to amplify the benefits of being classified as newly discovered oil "[t]o provide the appropriate

one knows what production would have been in the absence of the tertiary project." *Design of a Windfall Profit Tax*, *supra* note 113, at 26. The staff of the Joint Committee on Taxation suggested, as alternatives, exempting all production from a property on which a tertiary project was undertaken, or exempting production in excess of a high statutory decline rate. *Id.* The Ways and Means Committee opted for the second alternative.

²¹⁶ See note 110 *supra*.

²¹⁷ *Ways and Means Bill*, *supra* note 171, § 4991(a)(5)(B); WAYS AND MEANS REPORT, *supra* note 171, at 28.

²¹⁸ *Ways and Means Bill*, *supra* note 171, § 4991(a)(5)(C).

²¹⁹ *Ways and Means Bill*, *supra* note 171, § 4992(e). The Committee feared that nonqualifying properties would be subdivided to produce one or more qualifying properties, and, therefore, provided a tax rule limiting transfers which would override the pricing rules. WAYS AND MEANS REPORT, *supra* note 171, at 23 and 32. The pricing definition of property, however, traces the property by means of the producer's "historical and consistent" property determinations to the inception of price controls. See, e.g., Dep't of Energy Ruling 1977-2, § II-A. Thus, the pricing regulations, as interpreted by DOE, may well have contained the result sought by the Ways and Means Committee. The staff of the Joint Committee on Taxation, however, found the protection offered by the pricing regulation to be insufficient:

Although various DOE rulings have recognized the possibility of a producer transferring or "gerrymandering" property so as to obtain a higher price for future production, there appears to be no explicit DOE prohibition on a producer transferring part of a producing property to obtain a higher price for the production from the transferred portion. In enforcing price controls, DOE has denied new property classification in cases of transfers effected solely for the purpose of avoiding price regulations. Such an evaluation procedure, of course, would have to be undertaken on a case-by-case basis, could be subject to a substantial degree

production incentives."²²⁰ The base price was set at \$17, rather than the regular \$16 Tier 3 base price.²²¹ The inflation adjustment was increased by two percent, compounded quarterly, above the generally applicable rate.²²² And the first \$9 of windfall profit was subject to a 50 percent tax rate, instead of 70 percent.²²³

d. Alaskan Oil

The Ways and Means Committee treated Alaskan oil in much the same way as newly discovered oil. First, it reduced the amount of oil entitled to an exemption from the tax, but then it provided additional production incentives through the applicable tax structure for the oil that was covered by the tax. Existing production north of the Arctic Circle would be subject to the Tier 3 tax, rather than exempted as the Administration had proposed.²²⁴ New production north of the Arctic Circle would remain exempt.²²⁵ This decision was consistent with the policy underlying the Tier 3 tax since existing production north of the Arctic Circle would benefit from future OPEC price increases. The special structural treatment of taxable Alaskan oil consisted of a 50 percent tax rate, instead of a 70 percent rate,²²⁶ a \$7.50 base price instead of a \$5 to \$6 base

of circumvention, and in any case does not deal with the problem of transfers where other motives are present.

Design of a Windfall Profit Tax, *supra* note 113, at 24.

²²⁰ WAYS AND MEANS REPORT, *supra* note 171, at 14. The Committee had been advised that "[i]t is generally believed that production of newly discovered oil is more sensitive to price changes than other kinds of oil, and the question appears to be whether to tax it in tier three or exempt it entirely." *Design of a Windfall Profit Tax*, *supra* note 113, at 24. The Committee specifically rejected outright exemption, Daily Tax Rep. (BNA), June 13, 1979, at G-7, and decided to compromise by liberalizing the Tier 3 tax.

²²¹ *Ways and Means Bill*, *supra* note 171, § 4991(a)(1).

²²² *Ways and Means Bill*, *supra* note 171, § 4991(a)(3). A similar "incentive" inflation adjustment was used in the Natural Gas Policy Act of 1978. See Pub. L. 95-621, § 101(a).

²²³ *Ways and Means Bill*, *supra* note 171, § 4991(a)(2). The \$9 amount was subject to the newly discovered oil inflation adjustment, *Ways and Means Bill*, *supra* note 171, § 4991(a)(3)(B), but the adjusted amount was not eligible for the severance tax adjustment, *Ways and Means Bill*, *supra* note 171, § 4991(a)(4).

²²⁴ Existing production was from the Sadlerochit reservoir in the Prudhoe Bay field. It had been reported to the Committee that "[o]il production from the Sadlerochit reservoir was highly profitable at 1978 Alaskan prices (about \$5.25 per barrel), and there appears to be relatively little risk that a tax on oil from this reservoir using a base price of \$7 to \$8 would discourage production." *Design of a Windfall Profit Tax*, *supra* note 113, at 22. Production costs would be higher, however, for the other Prudhoe Bay reservoirs. *Id.* Moreover, "costs are unknown for any other Alaskan oil remaining to be discovered, and any tax on newly discovered Alaskan oil risks having an adverse impact on production." *Id.*

²²⁵ *Ways and Means Bill*, *supra* note 171, §§ 4988(a) and 4992(b)(6). The Committee specifically rejected a proposal to tax newly discovered Alaskan oil north of the Arctic Circle. Daily Tax Rep. (BNA), June 14, 1979, at G-6.

²²⁶ *Ways and Means Bill*, *supra* note 171, § 4991(b)(1)(A). Because of the lower tax rate, no state severance tax deduction would be allowed. *Ways and Means Bill*, *supra* note 171, § 4991(b)(1)(E); WAYS AND MEANS REPORT, *supra* note 171, at 31.

price,²²⁷ and adjustments for reductions in the Trans-Alaskan Pipeline System tariff.²²⁸

6. Other Provisions

a. *Public Education Exemption*

The Ways and Means Committee decided to exempt from the windfall profit tax crude oil allocable to an economic interest held by a state, political subdivision, or public educational institution, if all the net income received pursuant to the interest was dedicated to public education or placed in a permanent fund, the income from which was dedicated to public education.²²⁹ This seemingly narrow exception marked the beginning of a much larger effort generally to exempt from the windfall profit tax crude oil interests held by governmental units and tax-exempt organizations, many of which were located in oil producing states. The issue could be viewed as deciding whether windfall profit tax revenues should be retained by these taxpayers or transferred to the federal government, a matter of intense regional concern.

b. *Rejected Amendments*

The Ways and Means Committee rejected (i) a plowback provision, more lenient treatment for small producers of stripper oil, elimination of the deduction for the windfall profit tax,²³⁰ (ii) termination of the tax at the end of 1989, substitution of various flat percentage taxes on gross or net oil income and a flat \$3 per barrel tax,²³¹ and (iii) (one amendment)²³² phase-out of Tier 2 tax, taxing marginal oil in Tier 2, termination of the tax on newly discovered oil in 1990, and setting the tax rate to raise slightly more revenue than under the Administration proposal.

²²⁷ *Ways and Means Bill*, *supra* note 171, § 4991(b)(1)(B). See note 224 *supra*.

²²⁸ *Ways and Means Bill*, *supra* note 171, § 4991(b)(1)(C). At the time of the Ways and Means Committee mark-up of the windfall profit tax, the determination of the Trans-Alaskan Pipeline System tariff was the subject of controversy. Because the wellhead price of ANS oil was equal to the refiner's acquisition cost of crude oil less the ANS transportation costs, if resolution of the controversy resulted in a lower tariff, the wellhead price would increase accordingly. The TAPS adjustment was intended to prevent the windfall profit tax from applying to such increases in the wellhead price for Alaskan oil.

²²⁹ *Ways and Means Bill*, *supra* note 171, § 4992(f). The initial version of the exemption adopted by the Committee applied only to royalty interests the earnings on income from which were permanently dedicated to public education under the applicable state constitution. H.R. 96-3919, 96th Cong., 1st Sess. (Committee Print, June 18, 1979). The exemption was then changed to have broader application. The original version was probably limited to Texas; the revised version also covered California and Louisiana, and may have covered Oklahoma and Alaska as well. 125 CONG. REC. H5324 (daily ed. June 28, 1979) (remarks of Rep. Ullman); Washington Post, June 20, 1979, at A1, col. 6; Daily Tax Rep. (BNA), June 19, 1979, at G-2. The revision applied, for example, to oil interests owned by the City of Long Beach, California. 125 CONG. REC. H5287 (daily ed. June 28, 1979) (remarks of Rep. Lungren).

²³⁰ Daily Tax Rep. (BNA), June 14, 1979, at G-6.

²³¹ Daily Tax Rep. (BNA), June 19, 1979, at G-1 to G-3.

²³² *Id.*, at G-3.

Thus, the effect of the Ways and Means Committee mark-up was to increase the tax on old and new oil, allow a deduction for state severance taxes, and refine the treatment of newly discovered oil, incremental tertiary oil, and Alaskan oil. The Ways and Means revisions reflected a desire to increase the windfall profit tax burdens on known production, and provide comparatively reduced tax burdens for what the Committee perceived as more production-sensitive categories of oil.

C. The House Bill

The Ways and Means Committee asked for a closed rule for House consideration of the tax.²³³ Those seeking a stronger tax, however, sought a rule permitting a floor vote on further strengthening changes.²³⁴ Advocates of a weaker tax likewise sought an opportunity for floor votes. Consequently, the House Rules Committee cleared the windfall profit tax for floor action with separate votes on the Committee amendments *en banc*, one substitute to weaken, and one to strengthen the tax, and a motion to recommit with instructions.²³⁵

The weakening proposal, offered by Representatives Henson Moore and James Jones, consisted of five separate changes to the Ways and Means Bill:²³⁶ (1) reduction of the general tax rate from 70 percent to 60 percent, (2) phase-out of the Tier 2 tax, (3) taxing marginal oil in Tier 2 instead of Tier 1, (4) providing incremental tertiary oil the same beneficial treatment as newly discovered oil, and (5) terminating the tax on incremental tertiary oil and newly discovered oil after 1990. The Jones-Moore substitute moved closer to the Administration's proposal, especially during the early years of the tax, although Jones-Moore would have raised more revenue during those years.²³⁷ The first

²³³ *Id.*, at G-2.

²³⁴ Advocates of a stiffer windfall profit tax may have read the mood of the House as indicating a willingness to strengthen the tax: (1) on May 2, 1979, the House Commerce Committee narrowly defeated a proposal to extend oil price controls through 1980, (2) on May 19, 1979, the Ways and Means Committee approved a significantly stronger windfall profit tax than the Administration's proposal, and (3) on May 22 and 23, 1979, the House Democratic Caucus voted 153-82 and 124-96, respectively, in opposition to decontrol.

²³⁵ H. RES. 96-336, 96th Cong., 1st Sess. (1979); H.R. REP. 96-308, 96th Cong., 1st Sess. (1979); 125 CONG. REC. H5283-89 (daily ed. June 28, 1979); Daily Tax Rep. (BNA), June 26, 1979, at G-6. The Rules Committee rejected votes on a series of amendments, including repeal of the foreign tax credit and a special exemption for the first 1,000 barrels per day of production by an independent producer. New York Times, June 27, 1979, at A21, col. 4; Wall Street Journal, June 27, 1979, at 8, col. 2.

²³⁶ The Jones-Moore substitute is reprinted at 125 CONG. REC. H5085-89 (daily ed. June 25, 1979). It is similar to an amendment rejected by the Ways and Means Committee. See text at note 232 *supra*.

²³⁷ During the first five years of the tax, the Administration's proposal would have raised \$21.2 billion, the Jones-Moore substitute, \$23.3 billion, and the Ways and Means Bill, \$28 billion. 125 CONG. REC. H5329 (daily ed. June 28, 1979) (remarks of Rep. Jones of Oklahoma). Of course, these estimates do not reflect the tax termination provisions of the Jones-Moore substitute.

three changes were, in fact, embodied by the Administration's windfall profit tax proposal. The last two changes were close questions as a matter of policy. If newly discovered oil deserved special tax consideration, incremental tertiary oil arguably deserved the same consideration. Moreover, the desirability of a permanent tax, especially on production-sensitive oil, was questionable.

The proposal to strengthen the windfall profit tax, offered by Representative Shannon, contained only one change: the statutory decline rate for Tier 1 would be decreased from 1½ percent to 1¼ percent.²³⁸ In addition to causing more lower tier oil to be taxed at Tier 1 rather than Tier 2, the Shannon amendment would have extended the Tier 1 tax from July, 1984 to August, 1985.

Advocates of a stronger tax apparently misgauged the mood of the House. The Jones-Moore substitute was approved by a vote of 236-183²³⁹ while the Shannon amendment was defeated by 241-172.²⁴⁰ The House rejected a motion to recommit the bill with instructions to add a plowback provision²⁴¹ and then approved the tax.²⁴² Thus, as a result of House floor action, the windfall profit tax was weakened somewhat, although not below the levels generally proposed by the Administration. The momentum for a stronger tax, however, clearly had been reversed.

D. *The Finance Committee Bill*²⁴³

Stimulated by an expressed concern for production incentives, equity, and public purposes, the Finance Committee cut the revenues raised by the House version of the windfall profit tax approximately in half through exemptions and other special provisions. The Committee added six new exemptions to the tax, expanded the one exemption explicitly adopted by the House, and added a new exception to Tier 1 treatment.²⁴⁴

²³⁸ The Shannon amendment is reprinted at 125 CONG. REC. H5198 (daily ed. June 26, 1979). The amendment had been rejected by the Ways and Means Committee. See note 193 *supra*.

²³⁹ 125 CONG. REC. H5325-33 (daily ed. June 28, 1979).

²⁴⁰ 125 CONG. REC. H5333-36 (daily ed. June 28, 1979).

²⁴¹ 125 CONG. REC. H5336-42 (daily ed. June 28, 1979).

²⁴² 125 CONG. REC. H5342 (daily ed. June 28, 1979). [H.R. 96-3919, as passed by the House, is hereinafter cited as the *House Bill*.] The text of H.R. 3919 appears in 125 CONG. REC. H5316, H5321 (daily ed. June 28, 1979).

²⁴³ H.R. 96-3919, 96th Cong., 1st Sess. (Nov. 1, 1979) [hereinafter cited as the *Finance Committee Bill*]; S. REP. NO. 96-394, 96th Cong., 1st Sess. (Nov. 1, 1979) [hereinafter cited as the *FINANCE COMMITTEE REPORT*].

²⁴⁴ The Finance Committee Bill, reported on November 1, 1979, is remarkably similar to a September 11, 1979, windfall profit tax proposal offered by Senator John Chafee. A technical explanation of Senator Chafee's proposal is reprinted in *Daily Tax Rep. (BNA)*, Sept. 11, 1979, at J-1.

1. Structure

The House Bill generally imposed a 60 percent tax rate, with a special 50 percent rate reserved for newly discovered oil, incremental tertiary oil, and Alaskan oil. The Finance Committee decided instead to impose a 75 percent tax rate on Tier 1, and retain the 60 percent rate for Tiers 2 and 3.²⁴⁵

The House had limited the severance tax deduction to taxes imposed as of March 31, 1979, out of concern for state poaching on federal revenues. The Finance Committee liberalized the severance tax deduction by permitting post-March, 1979 severance tax increases to be taken into account if the increase applied to the entire removal price.²⁴⁶ Apparently, the Finance Committee was satisfied that the federal treasury was adequately protected if the severance tax deduction was denied only for targeted severance tax increases.²⁴⁷ The Finance Committee also allowed a severance tax deduction for severance taxes validly imposed by Indian tribes.²⁴⁸

The Committee further reduced windfall profit tax burdens by limiting the taxable windfall profit to 90 percent of net income from the property²⁴⁹ and by exempting from the tax oil used to produce oil or gas on the same property.²⁵⁰ In a technical change, the Committee agreed to treat the owner of a production payment as the taxpayer, reversing the House provision.²⁵¹ In sum, although the Finance Committee increased the Tier 1 tax rate, it also sought to mitigate liability under the tax through structural modifications.

²⁴⁵ *Finance Committee Bill*, *supra* note 243, § 4987(a). The 50 percent rate became irrelevant when the Finance Committee included Alaskan oil in Tier 2, and exempted newly discovered oil and incremental tertiary oil.

²⁴⁶ *Compare Finance Committee Bill*, *supra* note 243, § 4992(d)(2) with *House Bill*, *supra* note 242, § 4992(d)(2).

²⁴⁷ The Finance Committee may have concluded that oil producers would have sufficient incentive to object to severance tax increases for which producers would obtain no windfall profit tax benefit.

²⁴⁸ *Finance Committee Bill*, *supra* note 243, § 4992(d)(3); FINANCE COMMITTEE REPORT *supra* note 243, at 55.

²⁴⁹ Under the House Bill, the limitation was 100 percent of net income from the property. *Compare Finance Committee Bill*, *supra* note 243, § 4989(b)(1) with *House Bill*, *supra* note 242, § 4989(b)(1).

²⁵⁰ FINANCE COMMITTEE REPORT, *supra* note 243, at 54. According to the Committee, this clarification conformed to the interpretation used for depletion purposes. *Id.*; Senate Finance Committee Staff, *Proposed Amendments to the Windfall Profits Tax*, Oct. 5, 1979, reprinted in *Daily Tax Rep.* (BNA), Oct. 5, 1979, at J-1.

²⁵¹ *Compare Finance Committee Bill*, *supra* note 243, § 4992(a)(1) with *House Bill*, *supra* note 242, § 4992(a); see also note 134 *supra*. "No special provisions are made for production payments because the committee understands that production payment contracts usually provide for an automatic adjustment to reflect the imposition of additional severance taxes such as the windfall profit tax." FINANCE COMMITTEE REPORT, *supra* note 243, at 62. The Finance Committee position was ultimately adopted by the Congress. CONFERENCE REPORT, *infra* note 325, at 108. The Finance Committee also conformed the net income limitation transfer rule to reflect the possibility that a production payment owner could also be a transferee. *Compare Finance Committee Bill*, *supra* note 243, § 4989(b)(4)(B) with *House Bill*, *supra* note 242, § 4989(b)(4)(B).

2. Tier 1

The Finance Committee increased the tax rate to 75 percent,²⁵² but reduced the Tier 1 tax base significantly. Heavy oil was exempted from the wind-fall profit tax entirely²⁵³ and a new category of oil known as high water-cut oil was exempted from the Tier 1 tax. "High water-cut oil" was defined as oil produced from a property for which the ratio of water to oil produced during any 12-month period after 1977 is at least nine to one. This class of oil was not exempted entirely, but was placed in Tier 2.²⁵⁴

3. Tier 2

The Tier 2 tax base was altered in several significant ways. Consistent with the changes made in Tier 1, high water-cut oil was included in Tier 2.²⁵⁵ In addition, oil from the Sadlerochit reservoir in Alaska, which the House had included in Tier 3, was placed in Tier 2²⁵⁶ and heavy oil was excluded.²⁵⁷ By including Sadlerochit oil in Tier 2, the Finance Committee significantly altered the tax burden on Alaskan oil. The base price became approximately \$13 instead of \$7.50; a severance tax adjustment was provided; and the tax rate was increased to 60 percent instead of 50 percent. In addition, the special inflation adjustment for the Trans-Alaskan Pipeline System adjustment was elimi-

²⁵² *Finance Committee Bill*, *supra* note 243, § 4987(a)(1). The higher rate was justified "because the production of this oil is less sensitive to price and because it receives the greatest benefit from decontrol." FINANCE COMMITTEE REPORT, *supra* note 243, at 2. The Committee rejected a proposal to increase the Tier 1 decline rate to two percent. Daily Tax Rep. (BNA), Oct. 26, 1979, at G-5.

²⁵³ See text at notes 283-84 *infra*.

²⁵⁴ *Finance Committee Bill*, *supra* note 243, § 4991(f). During the applicable 12-month period, production must have been maintained at the "maximum feasible rate consistent with recognized conservation principles." See FINANCE COMMITTEE REPORT, *supra* note 243, at 35, 58. The special treatment of high water-cut oil was needed "[t]o prevent the shutting in of some lower tier properties where the production is unusually expensive" FINANCE COMMITTEE REPORT, *supra* note 243, at 27.

²⁵⁵ *Finance Committee Bill*, *supra* note 243, § 4988(c)(2). See note 254 *supra*.

²⁵⁶ *Finance Committee Bill*, *supra* note 243, § 4991(b). Compare *Finance Committee Bill*, *supra* note 243, § 4988(c) with *House Bill*, *supra* note 242, § 4988(c).

²⁵⁷ See text at notes 283-86 *infra*.

In addition, the Finance Committee modified the phase out of the Tier 2 tax. The House Bill required the Secretary of the Treasury, by regulation, to eliminate the difference between the Tier 2 base price and the Tier 3 base price over 50 months beginning in November, 1986. At the time, the amount of the difference was \$3 per barrel. The Finance Committee decided instead to provide a six-cent per month (\$3 divided by 50 months) increase in the Tier 2 base price over the same period. The aggregate increase in the Tier 2 base price would be approximately the same under either bill. Compare *Finance Committee Bill*, *supra* note 243, § 4990(d) with *House Bill*, *supra* note 242, § 4990(d). The change was explained as a simplification measure. FINANCE COMMITTEE REPORT, *supra* note 243, at 36. The Committee rejected proposals to tax Tier 2 oil at rates of 75 percent, 70 percent, and 50 percent. Daily Tax Rep. (BNA), Oct. 3, 1979, at G-8 to G-9, Oct. 9, 1979, at G-2 to G-3.

nated.²⁵⁸ The Administration had recommended that the Alaskan oil base price be increased to \$13 “[s]ince Alaskan oil does not benefit from decontrol until the wellhead price reached \$13 per barrel”²⁵⁹

4. Tier 3

The Finance Committee virtually eliminated the Tier 3 tax base. Most stripper oil owned by independent producers, incremental tertiary oil, and newly discovered oil were all exempted from the windfall profit tax.²⁶⁰ The remaining Tier 3 tax base consisted generally of stripper oil owned by integrated oil companies.²⁶¹ Thus, most of the taxable oil fell into Tiers 1 and 2. As a simplification measure, the Finance Committee lowered the Tier 3 base price from \$16 to \$15.30 to permit the same inflation adjustment to be used for all base prices.²⁶²

5. The Exemptions

The Finance Committee created numerous exemptions from the windfall profit tax, some based on characteristics of the oil, and others, on the nature of the taxpayer. Exemptions based upon characteristics of the oil were provided “[t]o encourage greater oil production”²⁶³ and “to eliminate, as much as possible, adverse effects on domestic production.”²⁶⁴ Taxpayer-oriented exemptions were generally provided “[i]n recognition of the fact that it is inappropriate to tax additional revenues . . . devoted to public uses”²⁶⁵ The various exemptions are described below.

a. *Newly Discovered Oil*

The Finance Committee exempted newly discovered oil from the windfall profit tax,²⁶⁶ and adopted the price control definition of newly discovered oil rather than the more restrictive House definition.²⁶⁷ The Committee tersely

²⁵⁸ Compare *Finance Committee Bill*, *supra* note 243, § 4991(b)(2) with *House Bill*, *supra* note 242, § 4991(b)(2). Staff estimates showed that, with Tier 2 treatment, an inflation-adjusted Trans-Alaskan Pipeline System adjustment would be almost the equivalent of exempting Alaskan oil. Daily Tax Rep. (BNA), Oct. 9, 1979, at G-3.

²⁵⁹ *Crude Oil Tax, Hearings on H.R. 3919 Before the Senate Comm. on Finance*, 96th Cong., 1st Sess., 48, 94 (1979) (statement of W. Michael Blumenthal) [hereinafter cited as *Finance Committee Hearings*]. See note 163 *supra*.

²⁶⁰ *Finance Committee Bill*, *supra* note 243, §§ 4988(a)(1), (2), and (4).

²⁶¹ FINANCE COMMITTEE REPORT, *supra* note 243, at 30.

²⁶² Compare *Finance Committee Bill*, *supra* note 243, § 4990(b)(1)(B) with *House Bill*, *supra* note 242, § 4990(b)(1)(B); see FINANCE COMMITTEE REPORT, *supra* note 243, at 38.

²⁶³ FINANCE COMMITTEE REPORT, *supra* note 243, at 2.

²⁶⁴ *Id.* at 6.

²⁶⁵ *Id.* at 28.

²⁶⁶ *Finance Committee Bill*, *supra* note 243, § 4988(a)(1).

²⁶⁷ Compare *Finance Committee Bill*, *supra* note 243, § 4991(a) with *House Bill*, *supra* note 242, § 4991(a)(5). See text at notes 216-19 *supra*. The Committee was advised by staff that the

described its decision as follows: "[t]he committee does not believe that the logic of a windfall profit tax extends to oil which has not yet been discovered and from which there can be no windfall."²⁶⁸ The Administration argued unsuccessfully that the production gains would not be worth the revenue loss, and that there was a windfall element attributable to future price increases dictated by OPEC.²⁶⁹ Apparently, the Committee did not accept this argument.

b. *Incremental Tertiary Oil*

Again, the Finance Committee not only provided an exemption,²⁷⁰ but liberalized the definition of oil qualifying for the exemption.²⁷¹ The computation of the amount of incremental tertiary oil followed the House Bill, except that producers could reduce the base level for periods before the project beginning date by the actual average monthly decline in production if it exceeded one percent per month.²⁷² Furthermore, under the House Bill, qualification as incremental tertiary oil could terminate if, for example, the project was found to be unnecessary or unsuccessful. This rule was criticized during the House debate as creating uncertainty, thereby deterring investments in tertiary recovery.²⁷³ The Finance Committee responded by stipulating that certain projects would be considered to continue in effect for tax purposes even if terminated provided the project is certified as being ineffective or counterproductive.²⁷⁴

The Finance Committee expanded the incremental tertiary oil definition by relaxing the House requirements for a qualifying project and by creating a separate certification role for state agencies. The Finance Committee dropped the requirements that the project be reasonably expected to result in a significant increase in the amount of crude oil ultimately recoverable, and that the project be uneconomic without the special windfall tax provision.²⁷⁵ Instead, the Finance Committee required only that the tertiary process "reasonably can be expected to enhance the ultimate recovery of crude oil"²⁷⁶ As explained by the Committee: ". . . it must be established that the overall amount of production expected to be obtained from the property (or project

revision entailed little, if any, revenue loss; DOE agreed that it was unlikely that a well in production in 1977 would be abandoned in 1978 if production was still economical. *Daily Tax Rep. (BNA)*, Sept. 25, 1979, at G-3.

²⁶⁸ FINANCE COMMITTEE REPORT, *supra*, note 243, at 7.

²⁶⁹ *Daily Tax Rep. (BNA)*, Sept. 25, 1979, at G-3.

²⁷⁰ *Finance Committee Bill*, *supra* note 243, § 4988(a)(2).

²⁷¹ *Finance Committee Bill*, *supra* note 243, § 4991(c).

²⁷² *Finance Committee Bill*, *supra* note 243, § 4991(c)(2)(A)(i).

²⁷³ 125 CONG. REC. H5308 (daily ed. June 28, 1979) (remarks of Rep. Pickle).

²⁷⁴ *Finance Committee Bill*, *supra* note 243, § 4991(c)(6)(E).

²⁷⁵ See *House Bill*, *supra* note 242, §§ 4911(c)(5)(A) and (B).

²⁷⁶ *Finance Committee Bill*, *supra* note 243, § 4991(c)(6)(A).

area) with the use of the tertiary process is significantly greater than the corresponding amount of oil production expected under pre-project conditions."²⁷⁷

In addition to DOE certification and self-certification, the Finance Committee added certification by a regulatory agency, including a state agency. This addition was:

intended, in part, to eliminate the need for duplicative proceedings, to give producers some additional certainty as to the qualifications of a project, and to reduce the *de novo* review obligations of the Internal Revenue Service. Because many jurisdictions require producers to obtain regulatory approval, and/or compulsory unitization, prior to the undertaking of a tertiary project, the use of regulatory certifications should advance these objectives.²⁷⁸

Whereas IRS review of self-certified projects would be subject to generally applicable tax audit rules,²⁷⁹ IRS review of agency-certified projects was made subject to a "substantial evidence" rule²⁸⁰ "because these projects would have been reviewed by that regulatory body prior to the time the exemption was claimed."²⁸¹ Under this rule, to challenge qualification, the IRS would be required to determine either that the agency's decision was not supported by substantial evidence on the record, or that evidence not in the record demonstrates the absence of qualification.²⁸²

c. Heavy Oil

The Administration somewhat belatedly proposed to exempt "heavy oil" from the windfall profit tax.²⁸³ As its first substantive decision on the tax, the Finance Committee followed the Administration's proposal²⁸⁴ using the price control definition of heavy oil.²⁸⁵ According to the Committee, most oil

²⁷⁷ FINANCE COMMITTEE REPORT, *supra* note 243, at 47. It is arguable that the Finance Committee did not intend to drop the first of these requirements (expectation of a significant increase in production): (1) in describing self-certified projects, the Committee retained the "significant increase" language, *id.* at 46; (2) in describing the general rules, the Committee required that expected production be "significantly greater" than production without the tertiary process, *id.* at 47; (3) in describing differences with the House Bill, the Committee mentioned only the House's "uneconomic" requirement, *id.* at 51. On the other hand, the Finance Committee Bill is clear that for all purposes, mere enhancement, not a significant increase, is required. *Finance Committee Bill*, *supra* note 243, § 4991(c)(6)(A).

²⁷⁸ FINANCE COMMITTEE REPORT, *supra* note 243, at 47.

²⁷⁹ *Id.* at 49.

²⁸⁰ *Finance Committee Bill*, *supra* note 243, § 4991(c)(6)(G)(i).

²⁸¹ FINANCE COMMITTEE REPORT, *supra* note 243, at 49.

²⁸² *Finance Committee Bill*, *supra* note 243, § 4991(c)(6)(G). See FINANCE COMMITTEE REPORT, *supra* note 243, at 50.

²⁸³ *President's Energy Address Fact Sheet*, *supra* note 115. See text at notes 115-16 *supra*.

²⁸⁴ *Finance Committee Bill*, *supra* note 243, § 4988(a)(3). See Daily Tax Rep. (BNA), Sept. 6, 1979, at G-2.

²⁸⁵ *Finance Committee Bill*, *supra* note 243, § 4991(e).

meeting this definition would be classified as stripper oil or tertiary production.²⁸⁶ If so, such oil would probably have been decontrolled already, and might well have been exempt from the windfall profit tax under other exemptions adopted by the Committee.

d. *Stripper Oil*

The Finance Committee exempted the first 1,000 barrels per day of stripper well production in which an independent oil producer held an economic interest.²⁸⁷ The purpose of the exemption was to stimulate production "because independent producers generally have undertaken a disproportionately large share of domestic exploratory drilling [The exemption] should encourage independent producers to increase their drilling activities and thereby supplement our domestic energy supply."²⁸⁸ In addition, the Committee explained, "stripper oil has been exempt from controls since 1976 and, therefore, will receive no benefit from the President's decontrol program [T]axation may lead to premature abandonment of stripper wells."²⁸⁹

e. *State and Local Governments*

The Finance Committee extended the House "public education" exemption to any "public purpose."²⁹⁰ This change was made despite the Administration's request that the House provision be deleted.²⁹¹ The exemption was described as requiring residents of consumer states to transfer money to producer state treasuries, with no production or conservation benefits.²⁹² An attempt to delete the exemption was rejected by the Committee.²⁹³

²⁸⁶ FINANCE COMMITTEE REPORT, *supra* note 243, at 51.

²⁸⁷ *Finance Committee Bill*, *supra* note 243, §§ 4988(a)(4) and 4991(d). The Committee rejected proposals to provide a 3,000 barrel-per-day exemption for independent oil producers (even after excluding royalty holders from the exemption), and exempting all stripper oil. Daily Tax Rep. (BNA), Oct. 2, 1979, at G-7 to G-8. It was estimated that the Finance Committee independent oil producer provision would exempt approximately 55 percent of all stripper oil and render nontaxable 60 to 75 percent of all producers. *Comparative Analysis of Two Bills*, *supra* note 113, at 37. The exemption was far from simple. If, with respect to the working interest in a property, independent oil producer ownership was (1) more than 50 percent, then all the oil from the property was eligible for the exemption, except in the hands of an integrated oil producer; (2) exactly 50 percent, then half the oil from the property was eligible for the exemption, except in the hands of an integrated producer; (3) less than 50 percent, then oil from the property was eligible for the exemption only in the hands of an independent oil producer actively engaged in the trade or business of producing oil and gas. The terms "independent oil producer" and "integrated oil company," and rules for allocating the 1,000 barrel per day amount, were derived from the percentage depletion provisions. *Finance Committee Bill*, *supra* note 243, § 4991(d)(2).

²⁸⁸ FINANCE COMMITTEE REPORT, *supra* note 243, at 27-28.

²⁸⁹ *Id.* at 7.

²⁹⁰ *Compare Finance Committee Bill*, *supra* note 243, § 4992(f) with *House Bill*, *supra* note 242, § 4992(f).

²⁹¹ *Finance Committee Hearings*, *supra* note 259, at 93.

²⁹² Daily Tax Rep. (BNA), Oct. 10, 1979, at G-10 (remarks attributed to Senator Danforth).

²⁹³ Daily Tax Rep. (BNA), Oct. 10, 1979, at G-10.

f. Indian Tribes

The Finance Committee exempted crude oil interests held by, or for the benefit of, Indian tribes, tribal organizations, or individual members of a tribe.²⁹⁴

g. Medical and Educational Charities

Economic interests in crude oil held by or for the benefit of medical and educational charities were also exempted from the windfall profit tax if the interests were so held on October 2, 1979.²⁹⁵ The Administration protested unsuccessfully against an earlier version of the exemption, arguing that windfall tax revenues would be cut with no increase in production and that the federal government should be used as the means to redistribute windfall profits.²⁹⁶

6. Other Provisions

a. Percentage Depletion

The Finance Committee deleted the House provision that subtracted the amount of a windfall profit for purposes of computing the percentage depletion deduction.²⁹⁷

b. Phase-Out of Tax

The Committee decided also to phase out the windfall profit tax once the Secretary of the Treasury had estimated that net revenues received by the Treasury under the windfall profit tax totalled \$127.1 billion.²⁹⁸ The phase-out would be implemented by exempting from the tax three percent of taxable crude oil each month following the Secretary's determination.²⁹⁹ This procedure was roughly equivalent to phasing out the tax by the end of 1990, but without the "notch" effect that termination on a date certain would produce. The Administration had requested that the windfall profit tax be a permanent tax.³⁰⁰

²⁹⁴ *Finance Committee Bill*, *supra* note 243, § 4992(g).

²⁹⁵ *Finance Committee Bill*, *supra* note 243, § 4992(h) (referring to I.R.C. § 170(b)(1)(A)). It was reported that the exemption "would benefit Yale and Princeton Universities, a crippled children's home in Texas, and other schools and hospitals." *Daily Tax Rep. (BNA)*, Oct. 25, 1979, at G-18. The exemption initially was limited to the Texas Children's Hospital, but later threatened to include most charitable organizations before being scaled back to the final version.

²⁹⁶ *Daily Tax Rep. (BNA)*, Sept. 21, 1979, at G-4.

²⁹⁷ See text at note 168 *supra*.

²⁹⁸ *Finance Committee Bill*, *supra* note 243, § 4993; FINANCE COMMITTEE REPORT, *supra* note 243, at 70.

²⁹⁹ *Finance Committee Bill*, *supra* note 243, § 4993.

³⁰⁰ *Finance Committee Hearings*, *supra* note 259, at 92-93.

7. Revenue Effects³⁰¹

It is worthwhile to compare the aggregate net revenues raised through 1990 by the House and Finance Committee Bills. The House Bill would have raised twice as much as the Finance Committee Bill: \$276.8 billion compared to \$138.2 billion, a difference of \$138.6 billion. Over half of the difference, \$71.0 billion, was attributable to the exemption of newly discovered oil. \$27.0 billion was attributable to the exemption of incremental tertiary production, \$16.2 billion to the stripper oil exemption, and \$12.3 billion to the heavy oil exemption. Thus, these four exemptions accounted for substantially all of the revenue difference between the two bills. \$5.9 billion of the difference was attributable to full Tier 2 treatment of Alaskan oil; \$3.7 billion to the percentage depletion change; \$2.9 billion to the phase-out; \$0.5 billion to high water-cut oil; \$0.4 billion to the Indian tribe exemption; and \$0.2 billion to the charitable school and hospital exemption. The increase in the Tier 1 rate to 75 percent raised an additional \$1.6 billion.³⁰²

Thus, the Finance Committee adopted and extended the Ways and Means approach to the windfall profit tax. The tax burdens on known production were increased still further; even greater incentives were provided to purportedly production-sensitive categories of oil; and additional non-production related tax relief was provided. In addition, the Finance Committee made the tax temporary, and eliminated the reduction in percentage depletion benefits. The result was a tax bill that would have raised less than half the revenue raised by the Ways and Means Committee Bill. Momentum for raising revenue would change again for the final time on the Senate floor.

E. *The Senate Bill*³⁰³

Lengthy Senate deliberations on the windfall profit tax became necessary in order to fashion a delicate balance of interests that would permit a bill to be passed. This process involved much trial and error. Although the Senate considered numerous amendments to the tax, the ultimate senatorial consensus involved a limited number of amendments, an agreement on the revenue to be raised by the Senate Bill, and the rejection of a key amendment whose fate was initially uncertain. What occupied the House of Representatives for 7½ hours

³⁰¹ FINANCE COMMITTEE REPORT, *supra* note 243, at 14-15. The revenue estimates were determined by subtracting from estimated gross windfall profit tax receipts the corresponding federal income tax reductions, and by assuming that the price of uncontrolled oil would equal \$30 per barrel in the fourth quarter of 1979 and would increase at the rate of inflation plus two percent per year. *Id.* at 9.

³⁰² *Id.* at 14-15.

³⁰³ H.R. 96-3919, 96th Cong., 1st Sess. (Dec. 17, 1979) [hereinafter cited as the *Senate Bill*].

on one single day required the attention of the Senate for 150 hours over 24 days.³⁰⁴

The Senate began the process of ascertaining relative voting strength by rejecting three amendments: reducing the general rate of tax in the House bill from 60 percent to 50 percent,³⁰⁵ reducing the tax rate on Tier 1 oil from 75 percent to 60 percent,³⁰⁶ and substituting the House Bill for the Finance Committee Bill.³⁰⁷ After prolonged debate, the Senate accepted an amendment that provided a 1,000 barrel-per-day exemption for all independent producer oil,³⁰⁸ expanding a similar Finance Committee exemption which had been limited to stripper oil.³⁰⁹ The independent producer amendment reduced the 1980-1990 revenues raised by the bill by \$9.9 billion³¹⁰ to \$128 billion, a reduction that

³⁰⁴ 125 CONG. REC. S18867 (daily ed. Dec. 17, 1979) (remarks of Senator Dole). Similarly, the Ways and Means Committee required only five days to report out H.R. 96-3919, whereas the Finance Committee needed "80-some hours" in executive session over 28 days. 125 CONG. REC. S16843 (daily ed. Nov. 16, 1979) (remarks of Senator Dole).

³⁰⁵ Rejected 32-53, 125 CONG. REC. S16869-71 (daily ed. Nov. 16, 1979). The amendment, even if adopted, would not have affected the Senate Bill. The amendment apparently was intended as a test of Senate sentiment. See 125 CONG. REC. S16869 (daily ed. Nov. 16, 1979) (colloquy between Senators Boren and Packwood).

³⁰⁶ Rejected 32-58, 125 CONG. REC. S16977 (daily ed. Nov. 19, 1979).

³⁰⁷ Motion to table agreed to 50-32, 125 CONG. REC. S17181 (daily ed. Nov. 26, 1979).

³⁰⁸ Adopted 53-41, 125 CONG. REC. S17284-85 (daily ed. Nov. 27, 1979). Senator Bentsen, the sponsor of the independent producer amendment, argued that it was justified because of the resulting increase in production: (1) due to price controls, Government regulatory policies, and the cost and difficulty of finding energy in the United States, the number of independent producers had declined in the past 25 years from 25,000 to 10,000; (2) independent producers drill 90 percent of U.S. exploratory wells; (3) independent producers find 75 percent of new oil and gas fields; (4) independent producers are responsible for 54 percent of new domestic oil and gas discoveries; (5) independent producers spend 105 percent of gross oil and gas income in drilling to find new oil and gas; (6) independent producers drilled 42,000 (84 percent) of the 50,000 wells drilled in the U.S. in 1978; (7) even with the exemption for newly discovered oil, further exemption was required to provide capital. "It is clear . . . that independent producers — not the majors — are the driving force in our efforts to discover new energy resources in this country." 125 CONG. REC. S17189-91 (daily ed. Nov. 26, 1979) (remarks of Senator Bentsen). Senator Ribicoff presented the opposing arguments, generally refuting the alleged increase in production: (1) a significant portion of the benefits would go to passive royalty holders; (2) although independents account for 75 to 80 percent of exploratory wells, they account for only 25 to 35 percent of U.S. production; this is because independents operate farm outs, develop leases held by majors, and exploit less promising leases on the most accessible reservoirs in mature production zones; (3) U.S. production is predominantly from giant fields, requiring expensive, long-term development; (4) since independents account for only 20 percent of the geographical and geological survey work, their success rate is lower than the majors and their fields are less prolific; (5) although the majors drill less, they have found more than 60 percent of the recoverable reserves; (6) production incentives are based upon rate of return, rather than present cash flow, and newly discovered oil, under the Finance Committee Bill, is exempt from the windfall profit tax; (7) independent producer drilling activity and profits had already demonstrated significant increases; (8) independent producer return on equity, availability of equity, and gross margins were more than adequate. 125 CONG. REC. S17274-77 (daily ed. Nov. 27, 1979) (remarks of Senator Ribicoff).

³⁰⁹ See text at notes 287-89 *supra*.

³¹⁰ 125 CONG. REC. S17189 (daily ed. Nov. 26, 1979) (remarks of Senator Bentsen).

would have to be "made up" once a revenue total for the Senate Bill was agreed to. The independent producer amendment represented the only major Senate action to weaken the windfall profit tax. It appears that by thus accommodating the interests of independent producers, it became possible to develop the necessary consensus to terminate a filibuster, increase the revenues raised by the Senate Bill, and pass the bill.

On the day following the adoption of the independent producer amendment, a motion to table an amendment increasing the Tier 2 tax rate from 60 to 75 percent failed by a vote of 39-58.³¹¹ This vote suggested the sentiment of the Senate for strengthening the tax, and provided the impetus for opponents and supporters of the tax to work out a compromise. One week later, by informal agreement among Senate leaders, it was decided that the total revenue to be raised by the Senate Bill from 1980-1990 would be \$185 billion,³¹² an agreement that would control subsequent substantive changes. The Senate then rejected a proposal to make the tax permanent,³¹³ but agreed to increase the Tier 2 tax rate to 75 percent,³¹⁴ and to raise the phase-out target from \$141.2 billion to \$210 billion.³¹⁵

The balance of the debate on the tax revolved around two amendments: a so-called "minimum tax," and the exemption of oil interests held by states and by state agencies and instrumentalities. The "minimum tax," in actuality, was an amendment to impose certain tax rates, base prices, and inflation adjustments on newly discovered oil, incremental tertiary oil, and heavy oil, all of which were exempt under the Finance Committee Bill. The amendment was to supply the revenue needed to reach the \$185 billion goal, and represented the last element of the overall Senate compromise on the tax. Initially, the minimum tax proposal subjected the three categories of oil to a 20 percent tax,

³¹¹ 125 CONG. REC. S17403 (daily ed. Nov. 28, 1979).

³¹² 125 CONG. REC. S17714 (daily ed. Dec. 4, 1979) (remarks of Senator Dole).

³¹³ Rejected 39-54. 125 CONG. REC. S17721 (daily ed. Dec. 4, 1979). During the debate, Senator Long appropriately noted that "[m]ost people believe that windfall is a short one[;] in the long run, the forces of supply and demand come into balance, and certainly all that ought to happen within a 10-year period. Therefore, it is suggested that there ought to be a phaseout, that this tax should not go on forever." 125 CONG. REC. S17720 (daily ed. Dec. 4, 1979) (remarks of Senator Long).

³¹⁴ The vote was 58-35. 125 CONG. REC. S17716 (daily ed. Dec. 4, 1979). The amendment increased the revenues of the Senate Bill by \$22.5 billion. 125 CONG. REC. S18037 (daily ed. Dec. 7, 1979) (remarks of Senator Muskie). Proponents of the amendment noted that the supply response to the rate increase had been estimated to change "only marginally." *Comparative Analysis of Two Bills*, *supra* note 113, at 47; *see also* 125 CONG. REC. S17388 (daily ed. Nov. 28, 1979) (remarks of Senator Bradley).

³¹⁵ Agreed to, 68-26. 125 CONG. REC. S17725 (daily ed. Dec. 4, 1979). This change was presumably necessary to accommodate the \$185 billion 1980-1990 revenue goal. According to its sponsor, the \$210 billion figure "has been reached through careful negotiation and discussion on both sides of the aisle between advocates of no tax and advocates of a total tax." 125 CONG. REC. S17722 (daily ed. Dec. 4, 1979) (remarks of Senator Moynihan). The amendment increased the 1980-1990 revenues of the Senate Bill by \$4.5 billion. 125 CONG. REC. S18037 (daily ed. Dec. 7, 1979) (remarks of Senator Muskie).

\$16.30 base price, and an inflation adjustment two percent above the otherwise applicable inflation adjustment.³¹⁶ The newly discovered oil part of the proposal was subsequently modified by decreasing the tax rate to 10 percent and increasing the base price to \$19.30. To accommodate the revenue loss associated with this modification, the base price for Tier 2 oil would be reduced by \$0.25.³¹⁷ The minimum tax proposal, as modified, was then adopted by the Senate.³¹⁸

A more sensitive problem was Senator Danforth's amendment to delete the exemption from the tax for oil interests owned by states and by state agencies and instrumentalities. The Danforth amendment was at issue throughout most of the Senate debate. Adoption of the amendment threatened to destroy the fragile consensus that had been assembled for passage of the bill. Debate on the amendment departed almost entirely from the basic dichotomy of increased production versus the need for revenues and equitable treatment of windfalls. The exemption clearly had nothing to do with increased oil production; rather, its advocates maintained that application of the windfall profit tax to state oil interests would be unconstitutional, and an invitation to further federal encroachment on traditional state prerogatives.³¹⁹ Advocates of the Danforth amendment emphasized the regional nature of the exemption: from 1980-1990, \$128 billion of additional revenues would go to states with oil production; of that amount, 83 percent would go to Alaska, Texas, California, and Louisiana.³²⁰ The increased revenues would allegedly be used to induce businesses and people to relocate in those states. According to Senator Danforth, "[t]he basic issue here is the flow of economic power within the United States."³²¹ After extensive debate and threats of a filibuster if the amendment was adopted, the Senate rejected the Danforth amendment.³²² Shortly thereafter, the Senate passed the windfall profit tax bill by a 74-24 vote.³²³

³¹⁶ 125 CONG. REC. S18141 (daily ed. Dec. 10, 1979) (amendment no. 777). The minimum tax proposal was estimated to increase Senate Bill revenues by \$30.8 billion from 1980-1990, 125 CONG. REC. S18185 (daily ed. Dec. 11, 1979) (remarks of Senator Muskie), and therefore bring the Senate Bill up to the compromise revenue target of \$185 billion.

³¹⁷ 125 CONG. REC. S18498, S18564 (daily ed. Dec. 14, 1979). The revenue goal slipped from \$185 billion to \$178 billion. 125 CONG. REC. S18564 (daily ed. Dec. 14, 1979) (remarks of Senator Dole).

³¹⁸ 125 CONG. REC. S18567-68 (daily ed. Dec. 14, 1979).

³¹⁹ See Senator Long's lengthy statement in opposition to the Danforth amendment. 125 CONG. REC. S18461-68 (daily ed. Dec. 13, 1979).

³²⁰ 125 CONG. REC. S18055 (daily ed. Dec. 7, 1979) (remarks of Senator Chafee).

³²¹ 125 CONG. REC. S18055 (daily ed. Dec. 7, 1979). See also 125 CONG. REC. S18052-70 (daily ed. Dec. 7, 1979); 125 CONG. REC. S18651-75 (daily ed. Dec. 15, 1979).

³²² Motion to table agreed to, 65-28. 125 CONG. REC. S18674-75 (Daily ed. Dec. 15, 1979).

³²³ 125 CONG. REC. S18863 (daily ed. Dec. 17, 1979). The Senate adopted, mostly by voice vote, numerous amendments, clarifications, and modifications with minor revenue impacts: clarification of term "maximum feasible rate," 125 CONG. REC. S17669 (daily ed. Dec. 3, 1979) (colloquy between Senators Boren and Long); amendment of the definition of "heavy oil"

As a result of action on the Senate floor, windfall profit tax burdens were increased on known production, reimposed on newly discovered, incremental tertiary, and heavy oil, and further weakened for independent producers. But perhaps most important of all, the Senate in fact passed an oil tax, something it would not do in the prior Congress.³²⁴

F. *The Conference Agreement*³²⁵

The core of the Conference agreement, as with the Senate Bill, was a compromise on the revenues to be raised by the windfall profit tax. The first decision made by the conferees was that the revenues raised by the windfall profit tax from 1980 to 1990 should fall exactly half-way between the House and Senate Bills: \$227.3 billion.³²⁶ The agreement on revenues effectively limited the conferees to deciding how the tax burden would be distributed, and provided the norm by which various configurations of substantive tax provisions would be tested.

The basic distributional decisions involved the allocation of the tax burden between independent oil producers and the major oil companies, and between existing production and new production. Under the House Bill, independents were responsible for \$57 billion (20.6 percent)³²⁷ of the \$276.8 billion raised.

to permit the determination to be made after June, 1979, 125 CONG. REC. S18035 (daily ed. Dec. 7, 1979) (remarks of Senator Cranston); reclassification of production from properties located in the Cook Inlet of Alaska from Tier 1 to Tier 2, 125 CONG. REC. S17706-07 (daily ed. Dec. 4, 1979) (remarks of Senator Stevens), S18109-12 (daily ed. Dec. 10, 1979); (1) clarification of use of price control BPCL to determine Tier 1 oil, (2) "carryover basis" for computation of net income limitation for transferred properties, (3) conform Tier 1 and Tier 2 base prices to price control ceiling prices, 125 CONG. REC. S18712-14 (daily ed. Dec. 15, 1979) (remarks of Senator Wallop); exemption of front-end tertiary oil from carbon dioxide and chemical surfactant injection projects, 125 CONG. REC. S18841-42 (daily ed. Dec. 17, 1979); expansion of the tax definition of "marginal oil" to include properties with an average daily production in 1978 of up to 40 barrels and an average completion depth of at least 10,000 feet ("deep" marginal oil), 125 CONG. REC. S18843-44 (daily ed. Dec. 17, 1979) (remarks of Senator Heflin); exemption of royalties on federal lands, 125 CONG. REC. S18700-01 (daily ed. Dec. 15, 1979), S18844 (daily ed. Dec. 17, 1979); expansion of Indian exemption to include Alaska Native Claims Settlement Act corporations, 125 CONG. REC. S18844-52 (daily ed. Dec. 17, 1979). In addition, the Senate rejected the following: elimination (except for heavy oil) of the amount of the windfall profit in computing percentage depletion, 125 CONG. REC. S17726-29 (daily ed. Dec. 4, 1979), S17802-14 (daily ed. Dec. 5, 1979); provision of a plowback credit, 125 CONG. REC. S17945-58 (daily ed. Dec. 6, 1979); substitution of an excess profits tax for the windfall profit tax, 125 CONG. REC. S18113-25 (daily ed. Dec. 10, 1979); provision of a plowback credit for certain Alaskan expenditures, 125 CONG. REC. S18125-27, S18135-37 (daily ed. Dec. 10, 1979).

³²⁴ See Note 3 *supra*.

³²⁵ H.R. 96-3919, 96th Cong., 2d Sess. (Mar. 7, 1980), H.R. REP. 96-817, 96th Cong., 2d Sess. (Mar. 7, 1980) [hereinafter cited as CONFERENCE REPORT]; Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, 94 Stat. 229 (Apr. 2, 1980). Section references hereinafter are to the Internal Revenue Code of 1954, as amended by the Crude Oil Windfall Profit Tax Act.

³²⁶ Daily Tax Rep. (BNA), Dec. 20, 1979, at G-5.

³²⁷ 125 CONG. REC. H1837 (daily ed. Mar. 13, 1980) (remarks of Rep. Vanik). The denial of percentage depletion on the windfall profit accounted for \$12.9 billion; the 1,000 barrel-

Under the Senate Bill, independents contributed only \$1 billion (0.6 percent) of \$177.8 billion in revenues.³²⁸ Thus, a key issue was how much, if any, of the additional \$49.5 billion in revenues needed to move from the Senate Bill to the conference revenue goal would be borne by independents. A closely related issue was how much of the balance of the required additional revenue would be paid from existing production and how much from production-sensitive categories, particularly newly discovered, incremental tertiary, and heavy oil.

The conferees were presented with numerous alternative arrangements of rates, base prices, etc., which approximately satisfied the revenue goal.³²⁹ In order to reduce the number of variables to be considered, the presentation incorporated certain simplifying assumptions concerning the tax, many of which would become part of the final conference decision: (1) to eliminate some complexity, Tiers 1 and 2 would be merged into a new Tier 1 with a \$12.80 base price, thereby eliminating further consideration of decline rates, cumulative deficiencies, and BPCLs;³³⁰ (2) the new Tier 1 base price would not be merged with the base price of the next tier;³³¹ (3) Alaskan oil would be taxed in new Tier 1;³³² (4) new Tier 2, comprised mostly of stripper oil, would be subject to a

per-day exemption for independents accounted for \$42.7 billion; and the balance (less than \$1 billion) was attributable to independent oil production in excess of the 1,000 barrel-per-day exemption. *See* Staff of the Joint Committee on Taxation, Conference Comparison on H.R. 3919, item II.B (Dec. 18, 1979).

³²⁸ Daily Tax Rep. (BNA), Jan. 18, 1980, at G-2.

³²⁹ Staff of the Joint Committee on Taxation, Windfall Profit Tax Options (Jan. 15, 1980), reprinted in Daily Tax Rep. (BNA), Jan. 15, 1980, at J-3, and Jan. 17, 1980, at G-4 [hereinafter cited as WINDFALL PROFIT TAX OPTIONS].

³³⁰ The consequence of the old Tier 1-Tier 2 distinction was a difference in base price of approximately \$7 per barrel (\$13 minus \$6). This difference represented the tax base attributable solely to the decontrol of lower tier oil. The difference in base price meant a difference in tax of \$4.20 (House Bill, with 60 percent tax rate) or \$5.25 (Senate Bill, with 75 percent tax rate). The Tier 1-Tier 2 distinction entailed enormous complexity. Moreover, the Tier 1 tax base had been significantly eroded. Under the House Bill, Tier 1 excluded marginal oil, front-end tertiary oil, and incremental tertiary oil. The Senate Bill added to the House exclusions Cook Inlet oil, high water-cut oil, heavy oil, "deep" marginal oil, most independent producer oil, and additional incremental tertiary oil. The complexities included defining all the tax base exclusions, computing BPCLs (three options under Senate Bill), applying decline rates (two options under Senate Bill), and accounting for cumulative deficiencies. Finally, Tier 1 would gradually phase into Tier 2 in any event by July, 1984. Thus, the Tier 1-Tier 2 distinction involved substantial complexity in order to impose a somewhat higher base price on a gradually diminishing quantity of oil over a limited period of time. The revenue reduction attributable to merging Tier 1 into Tier 2 would be made up elsewhere.

The proposed merger of Tier 1 into Tier 2 was adopted by the conferees. Merged Tier 1 oil, with approximately a May, 1979, new oil base price, generally includes oil subject to price controls as old oil or new oil prior to the inception of President Carter's decontrol plan. The staff initially recommended a \$12.80 base price for the merged Tier 1, which was approximately 3 cents above the Senate Bill Tier 2 base price and 22 cents below the House Bill Tier 2 base price. The conferees eventually selected a merged Tier 1 base price of \$12.81.

³³¹ Under the House Bill, the Tier 2 base price was gradually increased to the Tier 3 base price over the 50-month period ending December 31, 1990. *House Bill*, *supra* note 242, § 4990(d)(2). The Senate Bill eliminated the phase-up, which amounted to approximately \$3 per barrel. *Senate Bill*, *supra* note 303, §§ 4990(d)(2) and 4993A(d).

³³² Following the Senate Bill.

\$15.30 base price and a 60 percent tax rate;³³³ (5) new Tier 3, comprised of newly discovered, heavy, and incremental tertiary oil, would have a \$16.30 base price with an inflation adjustment two percent higher than the otherwise applicable adjustment;³³⁴ (6) most exemptions would be disregarded;³³⁵ (7) royalty owners would be excluded from any special treatment for independent producers;³³⁶ and (8) special treatment for independent producers would be limited to new Tiers 1 and 2.³³⁷ The alternatives presented to the conferees included combinations of: new Tier 1 tax rates between 65 and 75 percent; tax rates on newly discovered, incremental tertiary, and heavy oil between 20 and 45 percent; percentage depletion alternatives;³³⁸ and independent producer alternatives.³³⁹ Independent producers simplified matters somewhat by emphasizing that retention of full percentage depletion was more important than exemption from the windfall profit tax.³⁴⁰ The tradeoffs then reduced to the allocation of the tax burden on existing oil production as between majors and independents, and the allocation of tax burden as between existing oil production and newly discovered, incremental tertiary, and heavy oil.

³³³ Stripper oil was taxed at a 60-percent rate and \$16 base price under both bills.

³³⁴ Under the House Bill, newly discovered and incremental tertiary oil had a \$16.30 base price and the special inflation adjustment. Heavy oil was exempted by the Senate at the urging of the Administration, and therefore could fairly be treated on a par with newly discovered and incremental tertiary oil. Under the Senate Bill, incremental tertiary and heavy oil had a \$16.30 base price, newly discovered oil had a \$19.30 base price, and all three categories received the special inflation adjustment. The staff of the Joint Committee on Taxation recommended a uniform \$16.30 base price for these three categories of oil to simplify the tax (thus, it would not be necessary for tax purposes to distinguish incremental tertiary and heavy oil from newly discovered oil) and because there did not appear to be a "compelling" reason to treat any one of the categories differently from the others. WINDFALL PROFIT TAX OPTIONS, *supra* note 329.

³³⁵ Other factors, such as base prices, could be adjusted to compensate for the cost of any exemptions as they were agreed to.

³³⁶ Approximately 85 percent of royalty holders were excluded from the Senate independent producer exemption. *See, e.g.*, 126 CONG. REC. S2705 (daily ed. Mar. 20, 1980) (remarks of Senator Long). This result followed from a rule for royalty owners which made the exemption proportional to the working interests held by independent producers. *Senate Bill, supra* note 303, § 4991(d)(2)(A)(ii). Most working interests are not held by independent producers. But see note 393 *infra*; Reese, *Impact of the Windfall Profit Tax on the Royalty Owner*, 29 OIL & GAS TAX Q. 284 (1980).

³³⁷ It was suggested that limiting special treatment for independent producers to Tiers 1 and 2 would eliminate many of the complexities that would arise from the separate treatment of royalty holders. WINDFALL PROFIT TAX OPTIONS, *supra* note 329.

³³⁸ Full percentage depletion (the Senate Bill), no percentage depletion on the windfall profit (the House Bill), and percentage depletion on half the windfall profit.

³³⁹ No exemption (the House Bill), 1,000 barrel-per-day exemption of independent producer oil (the Senate Bill), 1,000 barrel-per-day exemption of stripper oil owned by independents (the Finance Committee Bill), and taxing 1,000 barrels-per-day of independent producer oil at 30-40 percent or at half the otherwise applicable tax rates.

³⁴⁰ Daily Tax Rep. (BNA), Jan. 17, 1980, at G-3. Perhaps there was an apprehension that a significant inroad on the percentage depletion base might invite further attacks on percentage depletion. The recent legislative trend has been to narrow percentage depletion benefits for oil and gas. Tax Reform Act of 1969, Pub. L. No. 91-172, § 501, 83 Stat. 487 (1969) had lowered the percentage depletion rate applicable to oil and gas wells from 27½ percent to 22 percent. The

The conferees agreed to a rate structure comprised of different rates for each tier and a separate set of rates for independent producers. Newly discovered, heavy, and incremental tertiary oil are grouped in a new Tier 3,³⁴¹ subject to a 30 percent tax rate³⁴² on a base price of \$16.55 per barrel.³⁴³ Stripper oil and National Petroleum Reserve oil are grouped in a new Tier 2,³⁴⁴ subject to a 60 percent tax rate³⁴⁵ on a base price of \$15.20.³⁴⁶ Tier 1 oil includes other, non-exempt production, consisting mostly of old oil and new oil,³⁴⁷ subject to a 70 percent tax rate³⁴⁸ on a base price of \$12.81.³⁴⁹ For independent producers, however, the tax rate is lowered³⁵⁰ to 50 percent for Tier 1 oil and 30 percent for Tier 2 oil for up to a total of 1,000 barrels per day of Tier 1 and Tier 2 production. In addition, the House proposal to reduce gross income eligible for percentage depletion by the amount of the windfall profit was abandoned.³⁵¹

After agreeing on the critical variables, the conferees turned to more detailed decisions, leaving to the end the question whether and how the tax would terminate. The basic structure for computing the tax follows the House and Senate Bills.³⁵² The tax base is labeled the "windfall profit," and is equal to the removal price of the oil reduced by the adjusted base price and by the

Tax Reduction Act of 1975, Pub. L. No. 94-12, § 501, 89 Stat. 26 (1975) had eliminated percentage depletion for major oil companies, and instituted a schedule limiting the percentage depletion quantity to 1,000 barrels per day per producer in 1980, and lowering the percentage depletion rate to 15 percent in 1984.

³⁴¹ I.R.C. § 4991(e)(1). Thus, the Tier 3 tax base is directly attributable to the Senate minimum tax amendment.

³⁴² I.R.C. § 4987(b)(3).

³⁴³ I.R.C. §§ 4989(d)(1)(B)(ii) and 4989(d)(2)(B)(ii).

³⁴⁴ I.R.C. § 4991(d)(1). If oil is described in Tier 2 and Tier 3, it is considered Tier 3 oil. I.R.C. § 4991(d)(2). Thus, for example, stripper oil that is also considered heavy oil is treated for windfall profit tax purposes as heavy oil. The Tier 2 tax base is essentially the same as the Senate Tier 3 tax base and the House Tier 3 tax base (treating newly discovered and incremental tertiary oil as a separate tier, which in fact they were after adoption of the Jones-Moore substitute).

³⁴⁵ I.R.C. § 4987(b)(1).

³⁴⁶ I.R.C. §§ 4989(d)(1)(B)(i) and 4989(d)(2)(B)(i).

³⁴⁷ I.R.C. § 4991(c). Oil described in other tiers is not considered Tier 1 oil. Tier 1 is a merger of "old" Tier 1 into "old" Tier 2. See note 330 *supra*.

³⁴⁸ I.R.C. § 4987(b)(1).

³⁴⁹ I.R.C. § 4989(c). The base price for existing Alaskan North Slope production (from the Sadlerochit reservoir) is reduced to reflect changes in the Trans-Alaska Pipeline System tariff. I.R.C. § 4996(d); see text at notes 228, 258 *supra*. The base price reduction is equal to any reduction in the tariff below \$6.26.

³⁵⁰ I.R.C. §§ 4987(b)(2) and 4992. For this purpose, royalty owners are not considered independent producers. I.R.C. §§ 4992(d)(1)(D) and 4992(d)(2).

³⁵¹ CONFERENCE REPORT, *supra* note 325, at 110. As described by Senator Long: These special rates for independents and protection of percentage depletion represent a sound compromise for the independents in light of the strong position of the House. This compromise recognizes the problems independents encounter in trying to compete with major companies and gives them an added cash flow which they will invest in drilling additional wells.

126 CONG. REC. S2611 (daily ed. Mar. 19, 1980) (remarks of Senator Long).

³⁵² I.R.C. §§ 4987 and 4988(a).

severance tax adjustment. The windfall profit is limited to 90 percent of the net income from the property.³⁵³ The amount of the tax is the product of the applicable tax rate multiplied by the windfall profit. Removal price is subject to related party and constructive sale rules;³⁵⁴ in addition, broad administrative authority is granted to conform removal price to fair market value.³⁵⁵ "Adjusted base price" is base price adjusted for inflation, with a lag of two calendar quarters.³⁵⁶ The severance tax adjustment is subject to two limitations. First, following the Senate Bill, post-March, 1979, increases in severance taxes are allowable only if the increases apply equally to the entire value of the oil.³⁵⁷ Second, reflecting the more restrictive House Bill, no adjustment is available to

³⁵³ I.R.C. § 4988(b). The conferees followed the Senate net income limitation rule, with some modifications. Thus, the net income limitation includes the "carryover basis" limitation on property transfers created on the Senate floor. See note 323 *supra*. In addition, § 251 of the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 (1980), added a new § 193 to the Internal Revenue Code, permitting certain tertiary injectant expenses to be deducted. Consequently, for purposes of computing the deemed cost depletion deduction in determining net income, taxpayers may elect to capitalize tertiary injectant expenses. I.R.C. §§ 4988(b)(3)(B)(iv), (b)(3)(C)(i)(II), and (b)(3)(E). This provision, created in the conference, conforms the treatment of tertiary injectants to that accorded intangible drilling costs in arriving at the net income limitation. Finally, the conferees decided, on their own motion, that gross income attributable to production payments would be included in the income of both the holder of the payment and the holder of the interest from which the payment was created. I.R.C. § 4988(b)(5). Under the Senate Bill, such gross income was included in the income only of the holder of the economic interest with respect to the oil. *Senate Bill, supra* note 303, §§ 4989(b)(5) and 4992(a)(1). See Prop. Treas. Reg. § 51.4988-2; Wulf, *Net Income Limitation Under Windfall Profit Tax*, 29 OIL & GAS TAX Q. 217 (1980); Statham and Keenum, *WPT Tier 1 Crude Subject to Built-in Excess Withholding*, OIL & GAS J., Oct. 20, 1980, at 125.

³⁵⁴ I.R.C. § 4988(c); CONFERENCE REPORT, *supra* note 325, at 105-06.

³⁵⁵ I.R.C. § 4996(f).

³⁵⁶ (1) *Tier 1 oil*. The base price is the May, 1979, upper tier ceiling price, which averaged \$13.02 per barrel, reduced by 21 cents. I.R.C. § 4989(c). The inflation adjustment for oil removed during any calendar quarter is the percentage by which the implicit price deflator for the gross national product for the second preceding calendar quarter exceeds the deflator for the second quarter of 1979. I.R.C. § 4989(b)(1). (2) *Tier 2 oil*. The base price averages \$15.20 per barrel. I.R.C. § 4989(d)(1). The inflation adjustment is the same as Tier 1. I.R.C. § 4989(b)(1). (3) *Tier 3 oil*. The base price averages \$16.55 per barrel. I.R.C. § 4989(d)(1). The inflation adjustment is the same as Tier 1, augmented by one-half percent per quarter. I.R.C. § 4989(b)(2). Interim base price rules for Tiers 2 and 3 were published as temporary regulations. T.D. 7690, 45 Fed. Reg. 23384 (Apr. 4, 1980), as amended by T.D. 7694, 45 Fed. Reg. 27929 (Apr. 25, 1980), and T.D. 7720, 45 Fed. Reg. 63263 (Sept. 24, 1980); see also Rev. Rul. 80-320, 1980-48 I.R.B. 15. Permanent base price rules for Tiers 2 and 3 have also been published as temporary regulations. T.D. 7721, 45 Fed. Reg. 64574 (Sept. 30, 1980), as amended by T.D. 7738, 45 Fed. Reg. 75206 (Nov. 14, 1980); see also Draft Regulatory Analysis, 80(10) STAND. FED. TAX REP. (CCH) ¶ 6809 (1980).

³⁵⁷ I.R.C. § 4996(c)(3)(B). See Temp. Treas. Reg. § 150.4996-2; Rev. Rul. 80-217, 1980-32 I.R.B. 11; Dickenson, *Severance Tax Adjustment Under the Windfall Profit Tax*, 29 OIL & GAS TAX Q. 257 (1980).

the extent the severance tax rate exceeds 15 percent.³⁵⁸ Finally, the windfall profit tax is imposed upon the producer of the crude oil.³⁵⁹

The conferees also refined the definitions of various oil classifications. Following the Senate Bill, newly discovered oil is defined by the terms of the price control regulations as such terms existed on June 1, 1979.³⁶⁰ Thus, any peregrinations in the interpretation of the price control rules are correspondingly reflected in the windfall profit tax.³⁶¹ By contrast, the definition of heavy

³⁵⁸ I.R.C. § 4996(c)(3)(A). This provision represents a minor accommodation to the regional concerns surrounding the exemption for state-owned oil interests and the deduction for severance taxes. Cf. I.R.C. § 2011 (federal estate tax credit for state death taxes — subject to a dollar limit); I.R.C. § 164 (federal income tax deduction for state real property, personal property, income, and sales taxes — not subject to a limitation).

³⁵⁹ I.R.C. § 4986(b); CONFERENCE REPORT, *supra* note 325, at 106-07; Temp. Treas. Reg. § 150.4996-1(b); Burke and Meyer, *Taxation of Net Profits Interests Under the Windfall Profit Tax*, 29 OIL & GAS TAX Q. 195 (1980).

³⁶⁰ I.R.C. §§ 4991(e)(2) and 4996(b)(8). The House Bill contained several restrictions on the price control definition. *House Bill*, *supra* note 242, § 4991(a)(5). See text at notes 216-18 *supra*.

³⁶¹ For example, the May 2, 1979, price control definition of newly discovered oil is based upon whether oil was *produced* from a property in 1978. See note 110 *supra*. This definition is controlling for windfall profit tax purposes. See text at note 360 *supra*. The March 7, 1980 Windfall Profit Tax Conference Report states, referring to a paraphrase of the price control definition, that 1978 production would be disregarded "if that production was incident to the drilling of exploratory or test wells and was not part of continuous or commercial production from the property during 1978." CONFERENCE REPORT, *supra* note 325, at 98. See also 126 CONG. REC. H1844 (daily ed. Mar. 13, 1980) (remarks of Rep. Jones of Oklahoma); 126 CONG. REC. S2839 (daily ed. Mar. 24, 1980) (colloquy between Senators Bellmon and Long). On June 23, 1980, DOE proposed amendments to the definition of newly discovered oil to refine the meaning of "production." DOE asked for comments on the above-quoted Conference Report statement, and on whether the "changes" should be retroactive to June 1, 1979. On July 14, 1980, DOE issued Ruling 1980-3, interpreting the term "produced." 45 Fed. Reg. 48577 (July 14, 1980) (to be codified in 10 C.F.R. ch. II). Here, *any* production would appear to be described by the term "produced": "Even though only 50 barrels of crude oil were produced in well tests from a property in calendar year 1978, for example, crude oil production from the property may not be certified and sold as newly discovered crude oil." 45 Fed. Reg. at 48579. In note 3 to Ruling 1980-3, DOE expressly disavowed the Windfall Profit Tax Conference Report statement as in any way affecting the definition of newly discovered crude oil for DOE pricing purposes. *Id.* Finally, I.R.C. § 4997(b) provides general authority to issue regulations interpreting the windfall profit tax, "including such changes in the application of the energy regulations for purposes of this chapter as may be necessary or appropriate to carry out such purposes."

DOE amended the definition of newly discovered oil, effective after 1980. See note 110 *supra*. Consequently, for price control purposes, one definition of newly discovered oil applied through 1980, and another in January, 1981. Thus, it is possible that (1) oil may be newly discovered for windfall profit tax purposes, but not for price control purposes; *query* whether, notwithstanding the legislative history of the windfall profit tax, such result is permissible under I.R.C. §§ 4991(e)(2) and 4996(b)(8) since the plain meaning of the tax statute is to adopt the price control regulations; and (2) regulations could be issued under I.R.C. § 4997(b) interpreting newly discovered oil for windfall profit tax purposes in accordance with the remarks made in the legislative history of the windfall profit tax, thus increasing the likelihood of two separate definitions of newly discovered oil for 1980, with conforming definitions thereafter. It appears that, in general, the Internal Revenue Service and the Treasury Department will consider using the

oil is supplied by the windfall profit tax, thereby modifying the price control definition and most likely precluding a future change in the price control rules from affecting the windfall profit tax.³⁶² Similarly, the definition of incremental tertiary oil is almost entirely supplied by the windfall profit tax rather than the price control regulations.³⁶³ Under the conference agreement, the tertiary project must reasonably be expected to result in "more than an insignificant increase" in recoverable oil,³⁶⁴ a less stringent test than the House Bill requirements of an expected "significant increase" in production coupled with the project being uneconomic without the preferential tax treatment.³⁶⁵ Senate Bill regulatory certifications and accompanying "substantial evidence" audit review standards have been retained,³⁶⁶ but revocation of a regulatory certification will cause the self-certification rules to apply rather than leave qualification generally unaffected.³⁶⁷ Furthermore, continuing tertiary qualification generally requires that the project be in effect and affect production; the Senate had adopted a "no fault" standard for continuing qualification of regulatory certified projects.³⁶⁸ Finally, the amount of incremental tertiary oil is production from a property in excess of a liberal statutory decline curve.³⁶⁹

authority granted by I.R.C. § 4997(b) to revise the price control rules for purposes of applying the windfall profit tax. 46 Fed. Reg. 24595 (May 1, 1981) (invitation for public comments on I.R.C. § 4997(b)); Legal Times of Washington, Apr. 27, 1981, at 1.

More intriguing are the possibilities if the June 1, 1979, price control definition of newly discovered oil is interpreted by a court to follow some new meaning, or, more perplexing, is invalidated. Presumably, due regard must be given to judicial interpretation of the June 1, 1979, price control regulations, although another court, even in the context of a tax case, might supply its own definition. If, however, all or a portion of the June 1, 1979, price control regulations is declared invalid, what happens for windfall profit tax purposes? Are such regulations, if declared invalid, "prescribed under section 4(a) of the Emergency Petroleum Allocation Act of 1973 . . ." as required by I.R.C. § 4996(b)(8)(A)? Or do the "terms" of the June 1, 1979, regulations continue in effect for tax purposes, as might be suggested by I.R.C. § 4996(b)(8)(C)(i)?

³⁶² I.R.C. § 4991(e)(3). For purposes of defining heavy oil, the Finance Committee Bill referred to the terms of Executive Order No. 12153 which decontrolled heavy oil. *Finance Committee Bill*, *supra* note 243, § 4991(e). On the Senate floor, the cross reference definition was replaced by the actual terms of the Executive Order, and by a modification to permit oil to qualify as heavy oil even if it did not so qualify prior to July 1, 1979. 125 CONG. REC. S18035 (daily ed. Dec. 7, 1979) (remarks of Senator Cranston). The effect of the floor amendment may have been to restrict the definition of heavy oil for tax purposes since the price control definition was expanded on December 27, 1979, to include oil of a lighter gravity. See note 116 *supra*. Thus, replacing a price control definition by a tax definition in order to liberalize tax treatment may have had an unexpected consequence.

³⁶³ I.R.C. § 4993.

³⁶⁴ I.R.C. § 4993(c)(2)(A).

³⁶⁵ House Bill, *supra* note 242, § 4991(c)(5)(A).

³⁶⁶ I.R.C. §§ 4993(c)(2)(D)(ii), (d)(5), and (d)(6). For initial state agency certification activity, see B. Sullivan, *Qualifying Tertiary Recovery Projects under the WPT Act*, OIL & GAS J., Feb. 2, 1981, at 71.

³⁶⁷ CONFERENCE REPORT, *supra* note 325, at 100; see generally *Senate Bill*, *supra* note 303, § 4991(c)(6)(D).

³⁶⁸ CONFERENCE REPORT, *supra* note 325, at 101; see generally *Senate Bill*, *supra* note 303, § 4991(c)(6)(E).

³⁶⁹ I.R.C. §§ 4993(a) and 4993(b)(1). See Verleger, *An Assessment of the Effects of the Windfall Profits Tax on Crude Oil Supply*, 1 ENERGY J. 41 (1980).

The conferees adopted most of the Senate exemptions with some modifications and adjustments. All state and local governmental interests in crude oil are exempt from tax,³⁷⁰ but oil owned by the federal government is subject to tax.³⁷¹ Certain oil interests held as of January 21, 1980 by or for the benefit of medical or educational charities,³⁷² or Indian tribes or individual Indians³⁷³ are exempt from tax. Certain Alaskan oil is exempt, depending on location.³⁷⁴ And

³⁷⁰ I.R.C. §§ 4991(b)(1) and 4994(a). Thus, the regional bias, if any, alleged by opponents of the exemption has been adopted. In theory, there is nothing to prevent a state or local government, or agency thereof, from purchasing an oil interest from a taxable entity, thereby sharing the benefits of the tax exemption. For example, production from an old oil property owned by a major producer is burdened by a 70 percent windfall profit tax rate, but is free from tax in the hands of a state or local government. Provided the transfer is otherwise desirable and permissible, the major producer could realize more after tax from the transfer, and the governmental entity could pay less than the after-tax value of the property.

³⁷¹ I.R.C. § 4991(d)(1)(B); CONFERENCE REPORT, *supra* note 325, at 107; see Interim Notice, Dep't. of the Interior, 45 Fed. Reg. 28824 (Apr. 20, 1980). Federal oil was taxed under the House and Finance Committee Bills. The Senate agreed to exempt federal oil in order to avoid merely transferring money from one federal pocket to another, based upon the representation that state income would not, as a result, be increased. 125 CONG. REC. S18844 (daily ed. Dec. 17, 1979) (colloquy between Senators Long and Danforth). One-half of certain federal royalties is paid to states, however. 126 CONG. REC. S3030-31 (daily ed. Mar. 26, 1980) (remarks of Senator Long). Consequently, states would benefit indirectly from an exemption of federal oil interests. In view of the representation to the contrary on which the Senate exemption was based, the Senate conferees receded to the House on this issue. 126 CONG. REC. S2623-24 (daily ed. Mar. 19, 1980) (colloquy between Senators Long and Wallop); 126 CONG. REC. S2714-15 (daily ed. Mar. 20, 1980) (remarks of Senator Long).

³⁷² I.R.C. §§ 4991(b)(1) and 4994(b). The exemption is limited to interests held on January 21, 1980, thereby curtailing transfers made for the purpose of benefiting from the exemption. The exemption is unavailable for reacquired interests or for interests transferred from one qualifying charity to another. The Conference agreement does not include bequests of interests made after January 21, 1980. CONFERENCE REPORT, *supra* note 325, at 108; *see also Senate Bill*, *supra* note 303, § 4992(h)(1)(B)(ii).

³⁷³ I.R.C. §§ 4991(b)(2) and 4994(d). The exemption also extends to the oil production prior to 1992 of Alaska Native Claims Settlement Act corporations.

³⁷⁴ Under the House Bill, oil produced north of the Arctic Circle other than Sadlerochit oil was exempt. *House Bill*, *supra* note 242, §§ 4988(a) and 4992(b)(6). Other new Alaskan production would have been taxed as newly discovered oil. Under the Senate Bill, all newly discovered oil produced north of the Arctic Circle, including all ANS oil other than Sadlerochit oil, was exempt. *Senate Bill*, *supra* note 303, §§ 4988(a)(1) and 4993A(a). *See FINANCE COMMITTEE REPORT*, *supra* note 243, at 43. The conferees agreed that all reservoirs tapped by a well located north of the Arctic Circle, other than Sadlerochit oil, should be exempt. I.R.C. § 4994(e)(1). In addition, the conferees exempted oil produced south of the Arctic Circle and north of the Alaska-Aleutian mountain range divide if the well is at least 75 miles from the nearest point on the Trans-Alaska Pipeline System. I.R.C. § 4994(e)(2). These locational exemptions reflect "the concern of the conferees that taxation of this production would discourage exploration and development of reservoirs in areas of extreme climatic conditions." CONFERENCE REPORT, *supra* note 325, at 103.

There has been some discussion concerning whether the conferees' Alaskan oil exemption is constitutional. *See Burke, The Windfall Profits Tax — The Power of Taxation or the Taking of Property?*, AM. OIL & GAS REP., March, 1980, 12; 126 CONG. REC. S3055-56 (daily ed. Mar. 26, 1980) (remarks of Senator Long); letter from Lloyd G. Ator, Jr., Senior Counsel, Office of the Legislative Counsel, United States Senate, to Senator Long (Mar. 25, 1980), *reprinted in* 126 CONG. REC. S3056-57 (daily ed. Mar. 26, 1980).

certain oil released under the price control program to finance tertiary recovery projects is exempt from tax.³⁷⁵

The phase-out of the tax represented one of the last major conference decisions. Under the House Bill, the tax on newly discovered oil and incremental tertiary oil, approximately 55 percent of projected 1990 production,³⁷⁶ terminated after 1990.³⁷⁷ The balance of the tax base would gradually phase out thereafter as existing production experienced further natural decline. Under the Senate Bill, the entire tax would phase out at the rate of three percent per month once net revenues derived from the tax reached \$189 billion,³⁷⁸ which was projected to occur in 1990. The conferees agreed that a three percent per month phase-out would begin once net revenues reach \$227.3 billion, provided, however, that the phase-out of the tax may not begin earlier than January, 1988, nor later than January, 1991.³⁷⁹ With this finishing touch, agreement between the conferees was reached.

G. Final Passage and Enactment

The Conference Report was approved by the House on March 13, 1980, by a vote of 302-107.³⁸⁰ After much debate, the Senate added its approval on March 27, 1980, by a similarly wide margin, 66-31.³⁸¹ The President signed the bill into law on April 2, 1980, almost one year to the day after he had proposed

³⁷⁵ I.R.C. §§ 4991(b)(4) and 4994(c); see Prop. Treas. Reg. § 51.4994-2. Under the House and Senate Bills, front-end tertiary oil was taxed using an upper-tier oil base price. *House Bill*, *supra* note 242, § 4991(d); *Senate Bill*, *supra* note 303, § 4988(b). In addition, under the Senate Bill, oil released to finance certain types of tertiary projects was exempt from tax. *Senate Bill*, *supra* note 303, § 4988(c). The conferees decided that for tertiary projects controlled by independent producers, all oil released to finance such projects would be exempt from tax. For all other projects, the windfall profit tax is refundable to the extent that the actual price control front-end tertiary benefit is less than the allowable benefit.

The front-end tertiary exemption is of limited application. Presumably, the exemption is of no further application after January 28, 1981, the date on which President Reagan ended price controls on domestic crude oil. See note 122 *supra*; I.R.C. § 4994(c)(4)(B). For a contrary view, see *Legal Times of Washington*, May 18, 1981, at 4. In addition, to the extent that the price control front-end tertiary benefit is computed net of the windfall profit tax, the front-end tertiary exemption may accelerate, but not otherwise augment the total economic benefit provided the producer, if the producer has sufficient lower tier oil to absorb the front-end tertiary price control benefit. It is the understanding of one of the authors that certain independent producers lacked sufficient quantities of lower tier oil to utilize fully a price control benefit computed net of the windfall profit tax. This situation encouraged the conferees to adopt the exemption from the tax for front-end tertiary oil, and to liberalize the exemption for independent producers.

³⁷⁶ *Comparative Analysis of Two Bills*, *supra* note 113, at Table A-5.

³⁷⁷ *House Bill*, *supra* note 242, § 4988(a)(2).

³⁷⁸ *Senate Bill*, *supra* note 303, § 4993.

³⁷⁹ I.R.C. § 4990.

³⁸⁰ 126 CONG. REC. H1861 (daily ed. Mar. 13, 1980). The sentiment of the House was perhaps more accurately expressed just prior to the vote on final passage when the House defeated a motion to recommit the Conference Report by a 227-185 margin. 126 CONG. REC. H1860 (daily ed. Mar. 13, 1980). Compare the House votes on original passage of the bill, *supra* text and notes at notes 239-42.

³⁸¹ 126 CONG. REC. S3151 (daily ed. Mar. 27, 1980). The Senate debated the Conference Report for seven days, Mar. 19-21, 24-27, 1980. A motion to recommit the Conference Report failed in the Senate by a 61-35 vote. 126 CONG. REC. S3134 (daily ed. Mar. 27, 1980).

it. Upon signing the bill, the President remarked, "the keystone of our national energy policy for which we have waited so long is now in place."³⁸²

The windfall profit tax signed into law by President Carter strongly resembled his own proposal in basic structure, but bore only marginal resemblance in the detail. Nevertheless, the Administration had achieved its basic goals. It adopted a program of administrative decontrol of oil prices which Congress left intact. And it asked for and received a windfall profit tax which would redirect hundreds of billions of dollars of domestic oil industry income to the federal government. An evaluation of these policies is set forth below.

III. CONCLUSIONS

For all its complexity and imperfections, the windfall profit tax ultimately may represent a positive contribution to domestic energy policy by making possible the elimination of oil price controls and by minimizing the risk that price controls on oil will be extended or reimposed in the future. Moreover, it is possible that, with some important exceptions, the tax will have a relatively small adverse impact on domestic oil production, and may, in certain cases, create significant production incentives. In addition, the tax will provide an important source of revenues to the federal government at a time when budgetary concerns are receiving considerable attention.³⁸³ These effects will be accompanied, however, by enormously complex tax rules and regulations, substantial private and public administrative costs, extensive controversies before the Internal Revenue Service and the courts, further federal legislative activity,³⁸⁴ and distortions in domestic oil investment decisions.

The question whether the windfall profit tax actually facilitated decontrol of domestic oil prices is both premature and beyond the scope of this article. Clearly, many of those responsible for the tax, both within the Carter Administration and in the Congress believed that absent some sort of windfall profits tax, administrative decontrol would halt or be rescinded. Moreover, many be-

³⁸² 16 WEEKLY COMP. OF PRES. DOC. 584, 584-85 (Apr. 2, 1980).

³⁸³ Even those who oppose the windfall profit tax in principle recognize its increasingly important role as a source of revenue. See Testimony of David Stockman, Director-Designate of Office of Management and Budget, before the Senate Governmental Affairs Committee, as reported in *Wall Street Journal*, Jan. 9, 1981, p. 5 at cols. 2 & 3. Such reliance on the windfall profit tax as a source of federal revenue is ironic. Republican senators and representatives strongly criticized the tax on the ground that the chief beneficiary would be the Federal Treasury. See *Ways and Means Report*, *supra* note 171, at 78-83 (minority views) ("... who shall reap the rewards of this bill? The federal treasury; ..." *Id.* at 83); *Daily Tax Rep. (BNA)*, Jan. 15, 1981, at K-3 (Senate conferees on the windfall profit tax are reported to have commented: "Once the federal government gets used to tremendous revenues generated by the 'windfall' taxes it will be unwilling — and unlikely — to give them up"; in addition, all but one of the Senate Republicans signed a letter urging the conferees to agree to termination of the windfall profit tax).

³⁸⁴ See note 393 *infra*, for revisions considered and enacted during 1980, and possible Reagan Administration proposals. Numerous proposals to amend the windfall profit tax were introduced early in the 97th Congress. See, e.g., *Daily Tax Rep. (BNA)*, Jan. 27, 1981, at G-3 to G-4.

lieved that as the September 30, 1981, date for expiration of statutory oil price control authority drew near, the political pressure for extending price controls might be irresistible without a tax in place, given the enormous increases in world oil prices.³⁸⁵ If these views were in fact controlling, then one reasonably might conclude that the windfall profit tax facilitated the realization of an important energy policy goal. As discussed above,³⁸⁶ perpetuation of price controls would have continued a program that discouraged energy conservation and domestic oil production, subsidized oil imports, and hindered the development of alternative energy sources. Decontrol will eliminate many of these problems and substantially increase the incentive to drill for oil in the United States. It is not surprising that despite the spectre and subsequent reality of the windfall profit tax, domestic drilling activity has increased by almost 50 percent since the decontrol decision was announced.³⁸⁷ If the windfall profit tax actually made decontrol possible, the tax would have to be extraordinarily counter-productive before its enactment outweighed the benefits of decontrol.

The windfall profit tax has been attacked precisely because it may have facilitated decontrol.³⁸⁸ Since this argument starts from a doubtful premise — that the continuation of domestic oil price controls is in the national interest — the argument is supportable only to the extent oil price control is sound public policy. Moreover, even for supporters of price controls, the windfall profit tax may represent a reasonable “second best” solution since the tax responds in part to the equity concerns addressed by price controls and also functions as a “continuation” of price controls, albeit in another form. Obviously, such critics would have preferred a tax that was both stronger and more permanent than the tax that was enacted.

The tax also has been criticized extensively as constituting a confiscation of income that rightfully belongs to oil producers. Even if its premise is accepted, this position appears to underestimate the political realities of reaching and maintaining decontrol in an era of ever-increasing world oil prices. There is a long history of imposition of federal controls on commodities such as

³⁸⁵ For example, it is possible that oil, which would have been controlled as “old” oil at approximately \$6 to \$7 per barrel, will sell for more than \$35 per barrel on October 1, 1981. See 126 CONG. REC. H1847 (daily ed. Mar. 13, 1980) (remarks of Rep. Conable); 126 CONG. REC. S3129 (daily ed. Mar. 27, 1980) (remarks of Senator Robert C. Byrd); Wetzler, *Energy Excise Taxes as Substitutes for Income Taxes*, 33 NATIONAL TAX J. 321, 322 (1980) (“With hindsight, it is likely that, despite the powerful economic case against the [oil price] controls, without the [windfall profit] tax there would have been no decontrol in 1979. The enormous gap between domestic and world oil prices, moreover, would have ensured an extension of controls in 1981.”) Mr. Wetzler was chief economist on the staff of the Joint Committee on Taxation throughout the consideration of the windfall profit tax.

³⁸⁶ See § I.B.5., *supra*.

³⁸⁷ See U.S. Dep’t of Energy, *Monthly Energy Review* 50 (Oct. 1980). During the first three months of 1979, an average of 1,460 exploratory and development wells per month were completed; from June through August, 1980, the average was 2,213 wells per month. For the same periods, average rigs in service per month increased from 2,078 to 2,949.

³⁸⁸ See, e.g., 125 CONG. REC. S16849-54 (daily ed. Nov. 16, 1979) (remarks of Senator Metzenbaum).

wheat, soy beans, and crude oil when imbalances between supply and demand threaten to cause sudden price increases.³⁸⁹ The risk of imposing controls is perhaps greatest in the case of crude oil because 50 to 60 percent of world supply is controlled by the members of OPEC, whose political instability, in turn, has contributed to the instability of world oil prices. Part of any increased producer income resulting from higher world oil prices, however, will flow automatically to the federal government through the mechanism of the windfall profit tax. Thus, in a sense, the tax may be viewed as an "insurance premium" to protect oil producers against the risk of reimposition of price controls in the event of a sudden increase in world oil prices. Accordingly, contrary to the "confiscation of income" view, it is arguable that the windfall profit tax will, in the long run, benefit oil producers by allowing a political consensus to form for the decontrol of domestic oil, and reducing the risk of reimposing price controls.³⁹⁰

Another common criticism of the tax is that it tends to reduce domestic oil production at a time when increased domestic production is in the national interest. The negative production effect is attributed either to reduced revenues or to lowered marginal returns. It is contended, for example, that simply by depriving oil producers of revenues, the windfall profit tax curtails production since the additional revenues would be invested in further drilling activities. This contention is contradicted by basic economic theory. The incentive to drill is determined where marginal costs equal marginal revenues, a determination which is only modestly affected by the windfall profit tax in the cases of certain types of production³⁹¹ and is actually enhanced in the case of incremental tertiary oil.³⁹² On the other hand, in the case of future production investments, marginal decision making, and, therefore, production, may well be affected by the tax. Thus, for example, production of newly discovered oil, tertiary oil, and heavy oil may be affected by the windfall profit tax since the anticipated marginal revenues from future production may be reduced by the tax. Therefore, starting from the premise that a windfall profits tax is desirable (in order to achieve decontrol), and assuming that the tax should have a minimal adverse effect on production, policy-justifiable modifications of the existing tax should tend to increase production, and, therefore, might reasonably reduce the tax burden on newly discovered, tertiary, and heavy oil.³⁹³ Even these revi-

³⁸⁹ For example, exports of soybeans were limited in 1973 in an effort to restrain increases in prices. See Executive Office of The President, *Economic Report of The President* 164 (1975). In addition, purchases of U.S. wheat by the Soviet Union have been limited by treaty. See Executive Office of The President, *Economic Report of The President* 161 (1977).

³⁹⁰ It should be recalled that a separate program of oil price controls began in 1973 on a "temporary" basis under a Republican administration.

³⁹¹ Verleger, *An Assessment of the Effects of the Windfall Profits Tax on Crude Oil Supply*, 1 ENERGY J. 47-58 (1980).

³⁹² *Id.*, at 41.

³⁹³ This discussion parallels the debate in the Senate on the so-called "minimum tax" on newly discovered, incremental tertiary, and heavy oil. See text at notes 316-18 *supra*. At the insistence of the Administration, the windfall profit tax was ultimately imposed on these

sions, however, would be desirable only if the windfall profit tax, as modified, was sufficient to avoid reimposition of price controls. *Some* lost production due to the tax would be preferable to the detriments of oil price controls.

It may also be expected that the windfall profit tax will result in unanticipated distortions of oil investment decisions. One of the authors has previously written³⁹⁴ that the incremental tertiary provisions create substantial economic incentives in certain circumstances. These provisions should induce unusual transactions between independent and major oil companies and will cause otherwise uneconomic enhanced recovery programs to be pursued while discouraging investment in economically justifiable recovery programs. In addition, the absence of a cut-off date in the exemption for certain governmental oil interests may lead to transfers of oil interests to governmental units in order to "share" the benefits of the exemption.³⁹⁵

Finally, the windfall profit tax is criticized as being astonishingly complex, even by the standards of federal income tax laws, and for imposing enormous private and public administrative costs. The complexity is attributable both to the structure of the tax and to the multitude of definitions to be applied. Oil is divided into numerous categories — newly discovered, incremental tertiary, heavy, stripper, National Petroleum Reserve, Tier 1, governmental, charitable, Indian, Alaskan, front-end, independent producer — each of which has its own special definitional rules and only one of which (heavy oil) is based upon the physical characteristics of the oil. The various categories are then assigned to four different groups. One group is exempt entirely from the tax; the others are subject to various tax rates, base prices, and inflation adjustments. There are four different tax rates, two inflation adjustments, and several systems for determining base prices. In addition, although price controls have been terminated,³⁹⁶ many of the price control rules are incorporated, and,

categories of oil, although at reduced rates. Unfortunately, the first proposals to modify the windfall profit tax reflected political rather than energy policy concerns. The 1980 budget reconciliation legislation included provisions to reduce the windfall profit tax on royalty holders and on stripper wells, neither of which reductions would appreciably have affected oil production. The royalty holder relief measure was in fact enacted, although only for windfall profit tax liabilities incurred during calendar year 1980. Subtitle D of Title XI of the Omnibus Reconciliation Act of 1980, Pub. L. 96-499, 94 Stat. 2599, 2961 (1980). By contrast, President Reagan's energy advisers have urged that the windfall profit tax be eliminated for newly discovered oil, heavy oil, and "incremental" oil. Report of the Energy Policy Task Force to Governor Reagan (Nov. 5, 1980), *reprinted in* Energy Users Rep. (BNA), Dec. 4, 1980, at 21. (The advisory group also urged repeal of the windfall profit tax on stripper oil, addition of a plowback provision if the tax continues on newly discovered oil, and earlier phase out of the tax. *Id.*) In addition, legislation adopted by the House and the Senate at the end of July, 1981, would provide substantial windfall profit tax reductions for royalty owners, independent producers, child care agencies, and newly discovered oil.

³⁹⁴ Verleger, *An Assessment of the Effects of the Windfall Profits Tax on Crude Oil Supply*, 1 ENERGY J. 41 (1980).

³⁹⁵ See note 370 *supra*.

³⁹⁶ See note 122 *supra*.

therefore, continued in windfall profit tax provisions, especially in the definitions and the base price rules. Furthermore, the windfall profit tax base is limited by a net income determination computed under certain percentage depletion rules, thus requiring reference to income tax rules in order to make a complicated series of computations. Finally, the windfall profit tax includes its own procedural provisions for withholding, deposit, payment, reporting, notification, and so on, adding to the substantive complexity of the tax itself.

The magnitude and complexity of the tax will undoubtedly create substantial private and public administrative burdens. The Treasury Department has been publishing, and will continue to publish, the myriad forms, regulations, and rulings needed to implement the tax. The taxpayer service, general legal, technical, compliance, and litigation functions of the IRS must be prepared to administer the tax, which eventually will entail administering many of the price control rules which so perplexed DOE.³⁹⁷ Paralleling the public roles, private accountants, record keepers, lawyers, and others will devote great effort to ascertaining, collecting, paying, reporting, planning, advising, and litigating with respect to the tax.³⁹⁸

Clearly, enormous public and private transaction costs will be attributable to the windfall profit tax. This perhaps was inevitable given the size and complexity of the domestic oil industry, and Congress' proclivity for writing a host of detailed distinctions into the tax laws, many in the name of fairness, others representing political compromises. It is understandable, therefore, that from time to time, there has been heard a plea to employ a simple per unit or per dollar excise in the place of the existing windfall profit tax formula.³⁹⁹ It ap-

³⁹⁷ An early indication of the administrative problems experienced by the government was provided in testimony on April 13, 1981, before the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Government Operations Committee by representatives of the Internal Revenue Service, General Accounting Office, and the U.S. Geological Survey. OIL & GAS J., Apr. 20, 1981, at 38; Daily Tax Rep. (BNA), Apr. 13, 1981, at G-1.

³⁹⁸ The constitutionality of the windfall profit tax has already been challenged directly. Independent Petroleum Association of America v. United States, No. C80-302 (D. Wyo., filed Oct. 14, 1980), as reported in OIL & GAS J., Oct. 13, 1980, at 82 and Oct. 20, 1980, at 104; Energy Users Rep. (BNA), Oct. 16, 1980, at 18. The complaint is reported to allege unconstitutionality on three separate grounds: (1) the tax is not uniformly levied geographically since certain crude oil in Alaska is exempted, in violation of article I, section 8, clause 1; (2) the tax constitutes a blatant confiscation of private property for which no compensation is offered, in violation of fifth amendment due process requirements; and (3) the tax also violates fifth amendment due process requirements because the tax will decrease oil production and increase oil demand, contrary to the purpose for which it was adopted. The government is reported to have moved for dismissal for three reasons: (1) absence of jurisdiction due to sovereign immunity; (2) absence of jurisdiction over the subject matter since no refund was claimed by the plaintiffs or denied by the Internal Revenue Service; and (3) prohibition against declaratory judgments or injunctions in federal tax actions. OIL & GAS J., Dec. 29, 1980, Newsletter. Two other cases alleging constitutional infirmities in the windfall profit tax have been dismissed on procedural grounds. Energy Consumers & Producers Ass'n v. Miller, Civ. No. 80-132-C (E.D. Okla., June 18, 1981); Lewis v. Reagan, 1981-1 U.S.T.C. (CCH) ¶ 9485 (D.D.C., June 9, 1981).

³⁹⁹ At the end of the Ways and Means Committee mark-up of the windfall profit tax, several proposals were made to substitute *ad valorem* excises for the Committee's windfall profit

pears, however, that once the emotional and technical investment is made in hundreds of refinements and compromises, a momentum is established which deters a return to simplicity.

Ultimately, as suggested above, one's view of the windfall profit tax depends on one's view of oil price controls and the role of the tax in eliminating price controls. Those who favor oil price controls, and those who believe that decontrol could be realized and maintained without resort to a windfall profits tax may conclude that the windfall profit tax represents bad energy policy and bad tax policy. If oil price controls are viewed as inimical to sound energy policy and it is concluded that a windfall profits tax was needed, at least on a temporary basis, in order to eliminate price controls, there is a reasonable basis for accepting, if not embracing, the windfall profit tax, with all of its blemishes, as a somewhat complex, imperfect means to a more rational domestic energy policy.

tax. Daily Tax Rep. (BNA), June 19, 1979, at G-3. A similar proposal emerged during the conference on the bill, arousing the strong objections of then Ways and Means Committee Chairman Ullman, who protested that the proposal "would involve scrapping all the work of the House and Senate in favor of charging off 'into the wild blue yonder.'" Daily Tax Rep. (BNA), Jan. 17, 1980, at G-3. See also 126 CONG. REC. H1844 (daily ed. Mar. 13, 1980) (remarks of Rep. Jones of Oklahoma); 126 CONG. REC. S2624 (daily ed. Mar. 19, 1980) (remarks of Senator Wallop). In formulating its windfall profit tax proposal, the Administration considered and rejected per unit and per dollar excises, since neither bore a defensible relationship to any "windfall." See note 131 *supra*. Hence, the resort to the standard windfall profit tax proposal of imposing a tax equal to a percentage of the difference between the sales price and a base price. The legislative process merely "refined" the standard proposal to reflect various congressional concerns.