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A PROPOSED RESPONSE TO THE ENERGY CRISIS: WINDFALL PROFITS TAXATION

I. Introduction

The United States energy situation has emerged in recent months as this country's most pressing national concern. Each day every American perceives and is subjected to its effects in the form of lowered thermostats, reduced high-way speeds, higher gasoline prices, and a barrage of media advertisements urging a more Spartan attitude towards energy consumption.

The magnitude of the crisis can no longer be denied. By 1985 the growth in per capita energy use is expected to increase by two-thirds over 1970.¹ The nation's primary energy needs will quite probably double in that fifteen year period, at an average annual rate of growth of 4.5 percent.² By 1985 the demand for oil will reach 30.2 million barrels per day, an increase of 15.5 million barrels per day over 1970. Given an \$85 billion investment by the petroleum industry in the search for new domestic energy sources between 1970 and 1985, an admittedly optimistic figure, demand will still exceed domestic supply in 1985 by 15.2 billion barrels per day.³ This development would leave the United States dependent on foreign sources for slightly more than half of its petroleum needs. The recent Arab oil blockade has conclusively demonstrated the precarious nature of such a dependence.

The seriousness of the situation has resulted in giving the highest priority to the development of new domestic sources of supply.⁴ While this is the long-run objective, the short-term analysis has provided an opportunity for a plethora of demagogic attacks upon the petroleum industry, pictured as reaping tremendous profits at the expense of the consumer.

Not surprisingly, most of these criticisms concern aspects of the tax system. Senator Adlai Stevenson has referred to the oil industry as "the Nation's largest and most pampered industry," and attacked such "tax advantages" as the depletion allowance and the deduction for intangible drilling and development costs.⁵ Senator Edward Kennedy has called for an excess profits tax on the petroleum industry "to prevent the oil companies from unfairly gouging the public."⁶ Congressman Robert Drinan has also objected to the favored treatment accorded by the tax structure to the petroleum industry.⁷

In response to these criticisms, President Nixon on December 19, 1973, asked Congress to impose a temporary emergency windfall profits tax on producers of crude oil.⁸ The Treasury explanation of the proposal states that the

1 THE CHASE MANHATTAN BANK, OUTLOOK FOR ENERGY IN THE UNITED STATES TO 1985 12 (1972).

2 *Id.* at 28.

3 *Id.* at 44.

4 See President Nixon's message to Congress on energy policy of November 8, 1973. 119 CONG. REC. 9823-25 (daily ed. Nov. 12, 1973).

5 119 CONG. REC. 23,750 (daily ed. Dec. 21, 1973).

6 *Id.* at 23,887.

7 *Id.* at 11,913 (daily ed. Dec. 20, 1973).

8 6 P-H 1974 FED. TAXES ¶ 59,103.

tax would be imposed at graduated rates (ranging from 10 to 85 percent) on increases in the per barrel price of oil above a ceiling price set by the Cost of Living Council. The base price will be subject to an upward adjustment after 36 months. The Administration also contemplates the establishment of an Energy Development Trust Fund to utilize the funds raised by the windfall profits tax to provide loans for the development of domestic energy resources. Finally, the Treasury explanation suggests that the tax be refunded or forgiven in the case of a producer who "plows back" his profits into energy-producing investment.⁹

This note will first establish criteria for judging instances of socioeconomic taxation, which may be broadly defined as tax measures (of which the windfall profits tax is a conspicuous example) specifically designed to implement governmental policies over and above the simple raising of revenue. The Nixon proposal for a windfall profits tax on the petroleum industry will then be analyzed in the light of these standards. It is submitted that such an analysis demonstrates that the tax (1) rests on a completely inaccurate formulation of national policy for dealing with the energy crisis, (2) represents a wholly inappropriate use of the tax system to implement that policy, and (3) is absolutely unworkable as a tax device.

II. Preliminary Theoretical Considerations

Tax scholars sharply divide on the validity of using the tax structure to promote non-revenue ends. Professor Surrey has strongly criticized the use of tax incentives to achieve socioeconomic desiderata.¹⁰ In his view several defects mar the utilization of such incentives. First, they frequently permit windfalls by paying a taxpayer for something he intended to do anyway for non-tax reasons.¹¹ Second, such incentives are inequitable since from the progressive rate structure of the tax system they favor high income taxpayers over low income taxpayers.¹² Third, tax incentives distort the choices of the marketplace in that a tax incentive to use a particular type of machinery, for example, will discourage the use of other, perhaps more efficient, devices.¹³ Finally, because such incentives are in effect a form of "back door" federal spending, they constrict the tax base and keep tax rates high.¹⁴ Professor Surrey concludes that in choosing between tax incentives and direct expenditures "the burden of proof should rest heavily on those proposing the use of the tax incentive method."¹⁵

Proponents of socioeconomic taxation argue that such incentives, and in particular investment incentives, serve to "moderate the impact of our progressive rate structure on investment income, and thus . . . encourage savings, investment, and capital formation."¹⁶ The crux of this argument is that such tax breaks

9 *Id.*

10 Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970).

11 *Id.* at 719-20.

12 *Id.* at 720-25.

13 *Id.* at 725.

14 *Id.* at 725-26.

15 *Id.* at 734.

16 Nolan, *The Use of the Taxing Power to Achieve Social and Economic Ends*, N.Y.U. 31ST INST. ON FED. TAX. 1621, 1633 (1973).

remain the only practical techniques for maintaining the high level of business investment necessary to increase production.¹⁷ Direct subsidies, it is contended, do not offer an adequate substitute for these tax incentives. For example, the Work Incentive Program (WIN), designed to encourage manpower training, proved such a dismal failure as a direct subsidy program that in the Revenue Act of 1971 Congress redesigned the program through the use of a tax credit.¹⁸

Professor Bittker adopts a position in between these two polar views.¹⁹ While deploring the "superheated rhetoric" of populist tax reformers who call for the elimination of every incentive contained in the Internal Revenue Code, he suggests that "these loopholes can be ranged in a hierarchy—from offensive, through debatable and trivial, to justified—and that we would do well to pick and choose among them"²⁰ Professor Stone has suggested appropriate criteria for this "pick and choose" process among tax incentives:

- (1) Will the tax incentive be effective to accomplish the desired goal?
- (2) Are other potentially more efficient efforts not likely to be enacted? And if enacted, not likely to succeed for various reasons (such as the alleged reluctance of business to apply for direct subsidies)?
- (3) Are the goals sought, in terms of their priority, important enough to compound the already existing evils of the tax system?
- (4) And finally, perhaps most important, are the goals sought of such clear national priority as to justify increasing the difficulties of budgeting under a system of direct expenditures and hidden indirect expenditures?²¹

More simply put, any socioeconomic tax proposal much face at the outset a two-fold inquiry: (1) What non-revenue policy is to be effected? (2) Does the proposed measure offer an efficient and workable means of implementing that policy?

The problems experienced under Section 169 of the Internal Revenue Code suggest, however, that a third criterion should be added to these two. That section permits the rapid amortization of "certified pollution control facilities" over a period of 60 months.²² While the section has been subjected to criticism on a number of grounds,²³ its most telling flaw is that it represents an attempt to

17 *Id.* at 1635.

18 INT. REV. CODE of 1954, §§ 40, 50A, 50B; Nolan, *supra* note 16, at 1636.

19 Bittker, *Income Tax "Loopholes" and Political Rhetoric*, 71 MICH. L. REV. 1099 (1973).

20 *Id.* at 1127.

21 Stone, *Tax Incentives as a Solution to Urban Problems*, 10 WM. & MARY L. REV. 647, 651 (1969).

22 INT. REV. CODE of 1954, § 169(a). The taxpayer may elect this rapid amortization deduction in lieu of the normal depreciation provisions of Section 167 of the Code. *Id.* To qualify, the "certified pollution control facility" must: (1) be a new identifiable treatment facility used in connection with a plant or other property in use before January 1, 1968; (2) have as its purpose the abatement or control of water or atmospheric contamination; and, (3) be certified by either federal or state pollution control authorities to be in conformity with the applicable state or federal pollution laws and regulations. *Id.* at § 169(d)(1). "New identifiable treatment facility" is defined to be tangible property subject to the depreciation allowance under Section 167 the construction, reconstruction, or erection of which is completed after December 31, 1968, or acquired after that date if the original use commences with the taxpayer after that date. *Id.* at § 169(d)(4). The facility must also be placed in service prior to January 1, 1975. *Id.* Finally, any profit-making facility fails to qualify for certification. *Id.* at § 169(e).

23 Critics contend that Section 169 is technically unsound due to its inordinate emphasis on "physical facilities." For example, the use of a different fuel or a change in the production

implement a policy, the abatement of pollution, for which the use of the tax structure is entirely inappropriate. The prime incentive for industries to invest in pollution control facilities is not the rapid write-off allowed by Section 169, but the force of state and local regulatory requirements as well as the bad publicity attendant upon suits by environmentalists.²⁴ It is through these means, and not the federal tax system, that the problems of pollution may be most effectively handled.

It is clear, then, that any proposal for a form of socioeconomic taxation must pass three tests. First, it must rest upon a clear and correct view of the proper national policy to be pursued by the tax device. Second, as seen from Section 169, that policy must be one to which the use of the tax structure is appropriate. Finally, the tax measure itself must be workable and efficient. It is against these standards that the concept of excess or windfall profits taxation must be judged.

III. The Nixon Proposal: Background, Analysis, Criticism

A. Past Applications of Excess Profits Taxation

While to many the concept of excess or windfall profits taxation may appear novel, in reality it forms a recurring theme in the history of the federal tax structure. Both World War I and World War II saw the imposition of an excess profits tax designed to curb war profiteering.²⁵ By far the most detailed and

process might do far more than any "control facility" to abate pollution, but such operational costs do not partake of the largess of Section 169. Millett, *Pollution and the Federal Revenue Code*, 8 WAKE FOREST L. REV. 535, 550 (1972).

Second, it is argued that Section 169 inequitably favors large over small corporations. If, for example, the rapid write-off provision were recast as an investment credit, it would be the equivalent of a 7.968 percent tax credit for investment by a 48 percent bracket corporation in pollution control equipment with a 15-year useful life. A corporation in the 22 percent bracket, on the other hand, would receive only the equivalent of a 3.653 percent credit for the same investment. Viewed as a direct expenditure, for the purchase of a certified pollution control facility costing \$150,000, Section 169 bestows \$11,952 upon a corporation with profits in excess of \$25,000 for the year in question, while a corporation receiving less than \$25,000 in profits would obtain \$5,479. If the corporation has no income or suffers a loss for the year in question, Section 169 confers no benefit whatsoever. McDaniel and Kaplinsky, *The Use of the Federal Income Tax System to Combat Air and Water Pollution: A Case Study in Tax Expenditures*, 12 B.C. IND. & COM. L. REV. 351, 360-62 (1971). These comparisons of Section 169 with the tax credit and direct expenditure methods presuppose: (1) the purchase of the \$150,000 property on the first day of the tax year; (2) a discount rate of 10 percent; (3) a normal useful life of 15 years with no salvage value; (4) neither corporation is subject to the minimum tax on tax preferences; (5) both corporations utilize the additional 20 percent first year depreciation deduction, and; (6) both corporations would have used the double-declining method to compute depreciation had they not chosen the rapid write-off provision of Section 169. *Id.* at 375.

24 McDaniel, *Alternatives to Utilization of the Federal Income Tax System to Meet Social Problems*, 11 B.C. IND. & COM. L. REV. 867, 883 (1970).

25 The World War I measure was the first attempt at excess profits taxation. In 1917, the tax was graduated into five brackets with the rates ranging from 20 to 60 percent. In 1918, a specific credit of \$3,000 plus 8 percent of invested capital was allowed in computing the excess profits tax. In the same year, the rates were changed to 30 percent on the first bracket up to 20 percent of the invested capital less the credit, and 65 percent on the remainder of the income. For the succeeding three years these rates became 20 and 40 percent respectively. Additionally, a war profits tax was imposed over and above this excess profits tax for 1918 only. All World War I excess and war profits taxes became ineffective after December 31, 1921. 8 CGH 1974 STAND. FED. TAX REP. ¶ 6100.01.

complex attempt to impose an excess profits tax, however, occurred in the Excess Profits Tax Act of 1950 (as amended by the Revenue Act of 1951).²⁶ A look at the provisions of this act will serve a far more important purpose than the satisfaction of dry historical curiosity; the sketchy and general explanation of the petroleum windfall profits tax offered by the Treasury²⁷ leaves the 1950 act as the only basis for prediction of the final form the Nixon measure will take.

As with the World War II legislation, the 1950 act applied only to corporations.²⁸ Although the Code provisions are extraordinarily complex, computation of the tax involved three theoretically simple steps.²⁹

First, a corporation had to compute its excess profits net income for the year in question. This was accomplished by making certain adjustments to the corporation's normal tax net income if any of a long list of items were present, including bad debt recoveries, gains and losses, dividends received, and special credits.³⁰ Also, a corporation could reallocate income to other years if the income during the excess profits tax year was "abnormal" in nature. To qualify for this relief, however, the "abnormal" income had to exceed 115 percent of income of the same class received in the four previous taxable years.³¹

Second, the corporation was required to compute its excess profits credit. As with the World War II legislation, this could be done in one of two ways. The "earnings" or "income" method allowed the taxpayer to earn a "normal" amount of income not subject to the excess profits tax. This "normal" amount was determined by comparing the current year's income with the average for the base period (1946-1949), and treating the difference as excess profits.³² This base period average was in turn determined by subjecting the net income for the base period years to substantially the same adjustments as those applied to normal tax net income for the year to which the excess profits tax applied to arrive at excess profits net income.³³ Abnormal base period deductions were "added back" to net income, thus increasing the base period net income and consequently the excess profits credit.³⁴ Also, the excess profits credit computed under the "earnings" or "income" method was increased for earnings retained in the business during or after the base period and decreased for reductions in capital after the base

World War II saw the imposition of a similar tax. It applied only to corporations, and only for taxable years beginning after December 31, 1939, and before January 1, 1946. The rates were 90 percent for 1942 and 1943, and 95 percent for 1944 and 1945, and were applied to the corporation's adjusted excess profits net income. These rates, however, were mitigated by an overall limitation that the sum of normal tax, surtax, and excess profits tax could not exceed 80 percent of the corporation's surtax net income. Further, there was provided a credit of 10 percent against the excess profits tax, computed under either the average earnings method (stressing earnings during the base period of 1936-1939), or the invested capital method. Corporations were also granted relief if they could demonstrate that the base period years were not normal either for the particular corporation or for the industry. *Id.* at ¶ 6102.

26 Int. Rev. Code of 1939, ch. 1, §§ 430-74, 64 Stat. 1137 (1950), as amended, 65 Stat. 541 (1951).

27 See text accompanying notes 8-9 *supra*.

28 Int. Rev. Code of 1939, ch. 1, § 430(a), 64 Stat. 1137 (1950).

29 Williamson, *The Excess Profits Tax Act of 1950*, 5 ARK. L. REV. 312, 314 (1951).

30 Int. Rev. Code of 1939, ch. 1, § 433(a), 64 Stat. 1139 (1950).

31 *Id.* at § 456(a)-(b), 64 Stat. at 1186.

32 *Id.* at § 435(a)-(e), 64 Stat. at 1148-52.

33 *Id.* at § 435(d)-(e), 64 Stat. at 1149-52.

34 *Id.* at § 433(b)(9)-(10), 64 Stat. at 1145-47.

period.³⁵ The second method of determining the excess profits credit, the "invested capital" method, involved a computation at graduated percentages based upon the amount of invested capital, with a provision for increasing the credit for new capital.³⁶

The third and final step in computing the excess profits tax was to subtract from the excess profits net income the sum of the excess profits credit (whether computed by the "earnings" or "invested capital" method) together with any "unused excess profits credit adjustment" (the latter a carryback or carryover of previously unused excess profits credit). To the remainder (termed the "adjusted excess profits net income") the excess profits tax was applied at a rate of 30 percent.³⁷ If the sum of the excess profits credit and unused excess profits credit was less than \$25,000, it was nonetheless raised to that amount, resulting in an automatic excess profits credit of \$25,000.³⁸ Moreover, the total amount of excess profits tax could not exceed 18 percent of excess profits net income.³⁹ The tax terminated for taxable years beginning on or after January 1, 1954.⁴⁰

The 1950 Excess Profits Tax Act drew heavy fire from tax commentators. The labyrinthine complexity of the law led one writer to denounce it as "perhaps the most bizarre and complex piece of tax legislation ever conceived by Congress and presented to harassed corporate taxpayers."⁴¹ Another author, although terming the legislation a "good job," nevertheless admitted that "under the present law there are at least 15 different ways of determining the net income a corporation may earn before being subject to excess profits tax."⁴² Beyond mere complexity, however, the law suffered from the more fundamental flaw that a distinction between "normal" and "excess" earnings was theoretically and practically impossible.⁴³ This feature of the act necessarily spawned "numerous glaring examples of special relief plainly tailored to a single company or at the most for the benefit of a few."⁴⁴

Measured against the three criteria for evaluating socioeconomic tax measures developed above, the history of excess profits taxation becomes a record of conspicuous failure. One may assume *arguendo* the satisfaction of the first two standards; the curbing of war profiteering may well be a proper national policy, and the tax structure may even be appropriate for the implementation of that

35 *Id.* at § 435(f)-(g), 64 Stat. at 1152-56.

36 *Id.* at §§ 436-38, 64 Stat. at 1156-61.

37 *Id.* at § 430-31, 64 Stat. at 1137-38.

38 *Id.* at § 431, 64 Stat. at 1138.

39 *Id.* at § 430(a), 64 Stat. at 1137.

40 *Id.*, as amended, 67 Stat. 175 (1953).

41 Williamson, *supra* note 29, at 312.

42 Brown, *Excess Profits Tax Is Here Again!* 36 IOWA L. REV. 460, 482-83 (1951).

43 Cary, *Pressure Groups and the Revenue Code: A Requiem in Honor of the Departing Uniformity of the Tax Laws*, 68 HARV. L. REV. 745, 756 (1955).

44 *Id.* at 755. Professor Cary provides the following illustration:

One of the baldest instances of preferential legislation is a section of the 1951 revenue act, providing for an alternative average base period net income with respect to any taxpayer which was engaged primarily in the newspaper publishing business and which after the middle of its base period and prior to July 1, 1950, consolidated with another newspaper published in the same locality. We may well ask how many newspapers of a size subject to excess profits tax possibly underwent a consolidation during the very brief period specified. Obviously one concern was singled out.

Id. at 756.

policy. Both the shakiness of its theoretical foundation and the cumbersomeness of its practical effect, however, demonstrate that excess profits taxation fails to satisfy the requirements of the third criterion of socioeconomic tax measures; it cannot be regarded as a workable and efficient tax device. It is against this unsuccessful historical backdrop that the Nixon proposal for a windfall profits tax on the petroleum industry must be analyzed.

B. *The Administration Proposal: Its Structure*

On December 19, 1973, the day on which President Nixon asked Congress to enact an Emergency Windfall Profits Tax on crude oil producers, the Treasury Department released its official explanation of the form the tax would take.⁴⁵ While this explanation is not particularly specific, it does give at least the general outlines of the measure sponsored by the Administration.

According to this explanation, because the demand for oil is going to increase and because higher cost sources must be utilized, in the long run the price of oil will have to increase by some reasonable amount. The current shortage, however, the Administration views as a short-term problem, believing that "supply and demand will come into normal balance—if permitted to operate in normal fashion—over a period of several years."⁴⁶ In the temporary crisis, nonetheless, oil producers have been afforded an opportunity to reap "windfall" profits, *i.e.*, profits in excess of the long-term supply price (defined by the Treasury explanation as that price "sufficient after two or three years to induce increased supplies and to dampen demand, so that shortages would disappear"; in the Treasury's estimation, that price would be \$7 per barrel for crude oil).⁴⁷

Thus the present problem is to establish a means for the efficient operation of price incentives within a reasonable range while preventing oil producers from retaining unusually large amounts in profits. In designing a windfall profits tax to solve this problem, three principles guided the Administration. First, the tax ought to capture both future and (to some degree at least) previous excess profits. Second, the tax should not be imposed on that part of the return to producers necessary to obtain increased production. Finally, the tax should gradually phase out as the essentially short-term windfall itself disappears.⁴⁸

With regard to the mechanics of the tax, it would be imposed at graduated rates on the sale of a barrel of crude petroleum at a price in excess of a specified base price per barrel. That base price, as set by the Cost of Living Council, would be the posted field price on May 15, 1973, plus 35 cents. The base price and the tax would apply to all crude oil sold after the date of enactment with the exception of crude petroleum produced abroad.⁴⁹

The Administration proposal divides price rises into six brackets and taxes them at rates ranging from 0 to 85 percent. For example, were a producer to raise the price of oil by \$2.50 per barrel, he would face a bracket tax of 40 cents

45 6 P-H 1974 FED. TAXES ¶ 59,103.

46 *Id.*

47 *Id.*

48 *Id.*

49 *Id.*

(since increases from \$1.71 to \$2.50 inclusive would be taxed at a 50 percent rate), and a cumulative windfall gains tax of 67½ cents. Any increase of \$2.51 or more per barrel would be taxed at a flat 85 percent rate. After 36 months, the lowest bracket is to be automatically moved upward so that the tax would only apply to price increases in excess of \$7 per barrel, the long-term supply price. Each higher bracket would correspondingly be moved upward as well. Finally, the Administration proposes that the tax should expire 60 months after its enactment unless otherwise extended.⁵⁰

The Administration also apparently favors allocation of the funds received through the windfall profits to an Energy Development Trust Fund to be administered by the Secretary of the Treasury. The fund would provide capital for an Energy Development Bank which would provide loans to finance projects for the discovery and conservation of domestic energy supplies where capital requirements exceed the capabilities of private commercial projects. The Bank would also have authority to extend loans to finance projects for environmental protection necessitated by the increased search for energy sources, to grant price guarantees for energy supplies produced by supported projects, and to provide for reinsurance against risks to the environment created by supported projects. Apparently the Bank is to have complete discretion both with regard to the particular projects to be supported and the terms on which credit is to be extended.⁵¹

The Treasury explanation also suggested that the tax be forgiven or refunded in the case of a producer who "plows back" his profits into energy producing investment. This could be implemented by either a deduction against the tax base (*i.e.*, the amount of excess profits) for qualifying expenditures or by a refund or credit of the windfall tax equal to the amount of such expenditures. Since the tax is to be collected by the first purchaser of the oil (who will in all likelihood be ignorant of the qualifying expenditures made by the producer), the tax refund or credit method is preferred by the Treasury.⁵²

C. The Administration Proposal: Its Problems

As has been seen, any socioeconomic tax measure must (1) rest upon a clear and correct national policy (2) for the implementation of which the use of the tax structure is appropriate and (3) for which a workable and efficient tax device may be formulated. The Nixon proposal fails on all three counts. In order to arrange the problems with the Administration's windfall profits tax in order of increasing seriousness, these three criteria will be applied to the measure in reverse order.

1. Workability

The same difficulties that rendered the 1950 Excess Profits Tax Act unworkable and inefficient⁵³ reappear in the Nixon proposal. At first glance the Admin-

50 *Id.*

51 *Id.*

52 *Id.*

53 See text accompanying notes 41-44 *supra*.

istration proposal appears far less complex since the tax is based on crude oil prices and not on excess profits per se as with the 1950 legislation. The "plow back" provision, however, demonstrates that a good deal of complexity lurks behind this simple facade. The tax base will not be simply the excess of the selling price over the base ceiling price but rather that excess less the credit or refund under the "plow back" provision. This is, of course, merely a revival of the "excess profits credit" of the 1950 act with all of its attendant complexity. Indeed, the Treasury explanation, in language strangely reminiscent of the 1950 act, speaks of the need to determine a "historical base level" of qualifying expenditures for "plow back" purposes and states that the refund or credit should only be given for expenditures in excess of that base level.⁵⁴ Furthermore, the explanation contains no definitions or examples of the term "qualifying expenditures" other than the general observation that such expenditures will generally be confined to the area of oil discovery and production.⁵⁵ If the eventual regulations governing this term become as complex as, for example, those defining "certified pollution control facility" under Section 169,⁵⁶ it is clear that a good deal of time will be wasted by oil producers in seeking IRS imprimaturs for their capital investment programs.

Moreover, the Administration proposal in no way solves the theoretical and practical difficulties inherent in any attempt to distinguish "excess" from "normal" profits.⁵⁷ The Treasury explanation gives no substantial basis for its quasi-mystical belief in the \$7 figure as the "long-term supply price."⁵⁸ If the complex calculations required under the 1950 act could not adequately separate "excess" from "normal" profits, that process will not be made any more efficient or workable by governmental fiat.

Even proponents of windfall profits taxation for the petroleum industry have found the Administration proposal neither workable nor efficient. It has been pointed out, for example, that since the maximum rate of the tax is 85 and not 100 percent, nothing prevents the oil companies from treating it as another cost of production and simply passing it on to the consumer.⁵⁹ Furthermore, since the base price is to be readjusted upward after 36 months to reflect the \$7 per barrel long-term supply price, while the tax is to remain in effect for 60 months, it is clear that for the last two years of its existence the tax will have little impact even as a revenue measure.⁶⁰

2. Appropriateness

Besides being unworkable and inefficient, the Nixon windfall profits tax is a wholly inappropriate use of the tax structure. If the crisis is as temporary as the Treasury believes and if the \$7 figure is an accurate estimate of the long-term supply price, then for the short run surely a system of price controls or price

54 6 P-H 1974 FED. TAXES ¶ 59,103.

55 *Id.*

56 Treas. Reg. § 1.169-2 (1971).

57 Cary, *supra* note 43, at 756.

58 6 P-H 1974 FED. TAXES ¶ 59,103.

59 119 CONG. REC. 11,912 (daily ed. Dec. 20, 1973) (remarks of Congressman Vanik).

60 *Id.* at 11,912-13.

renegotiation is far more appropriate for the curbing of windfall profits than an excess profits tax.⁶¹ There is no reason to add to the complexity of the federal tax structure when other more appropriate alternatives are available.

Moreover, the Energy Development Trust Fund and the "plow back" provisions further highlight the inappropriateness of windfall profits taxation. Taken together, they can only mean that large amounts of windfall profits will be returned to producers to form part of their capital investment structure. Were the Administration serious about helping the harassed energy consumer, instead of establishing this fiscal merry-go-round it would utilize the funds obtained from windfall profits taxation to provide capital for federally owned and operated discovery and development programs in domestic energy resources. These supplies could then compete in the market with supplies produced by private investment capital.

3. Policy

In a sense, all criticisms pertaining to the appropriateness of the tax structure to windfall profits taxation of the petroleum industry are somewhat artificial. The greatest flaw in the Administration proposal is that it does not rest upon the proper national policy for dealing with the energy crisis; this is so in two respects. First, the crisis is not a short-term affair; Americans will be living under its spectre for quite a while. The Administration's contention that, in effect, everything will come around again in two or three years, appears extraordinarily naive in light of the overwhelming evidence to the contrary.⁶²

More importantly, however, the windfall profits proposal fails to realize that the energy crisis is not one of scarcity of natural resources, but is rather a crisis in the amount of capital available for investment in the search for and production of those resources. Any windfall profits tax can only serve to exacerbate this "capital crisis."

Inadequate attention has been paid to the enormous capital requirements of the petroleum industry:

If they [the nation's oil and gas needs] were to be satisfied from domestic sources without any proportional increase in the dependence upon foreign supplies, the petroleum industry would have to carry on a drilling effort more than twice as great as in the preceding fifteen years. And the probable cost of such an effort, including all related activities, would be at least 140 billion dollars—measured in dollars of current value.⁶³

61 Section 110 of the proposed Energy Emergency Act of 1973, as the bill emerged from the conference committee, contained provisions for striking at windfall profits and price gouging by allowing interested parties who believed that the price charged them for petroleum products permitted windfall profits to petition the Renegotiation Board. The Board would have authority, if it determined that such windfall profits were being made, to specify prices which would not permit such profits, and to order sellers to refund to buyers amounts equal to such profits. Energy Emergency Act, S. 2589, 93d Cong., 1st Sess. § 110 (1973). The Senate, however, eventually deleted Section 110. 119 CONG. REC. 23,876, 23,886 (daily ed. Dec. 21, 1973). The House refused to accept this version of the bill. 119 CONG. REC. 12,013-30 (daily ed. Dec. 22, 1973).

62 See text accompanying notes 1-3 *supra*.

63 THE CHASE MANHATTAN BANK, *supra* note 1, at 39. The study also notes that:

One author estimates the total capital needs of the petroleum industry for the 1970's at \$550 billion, while noting that if the industry continues at its present growth rate (7%), it could generate only \$370 billion from operations.⁶⁴ None of these figures includes the even greater amounts of capital necessary for national self-sufficiency in energy—the Administration's "Project Independence."⁶⁵

The wealth of America's natural resource base cannot be doubted. Coal is present in an abundant supply.⁶⁶ The deposits of shale in the United States could easily yield 750 billion barrels of oil.⁶⁷ The exploitation and development of these resources, however, will require tremendous capital outlays.⁶⁸ If this country's goal for the energy crisis is to be national energy self-sufficiency through the utilization of domestic energy resources, then it is time to realize that such a policy is completely at loggerheads with any proposal for windfall profits taxation of the petroleum industry.

IV. Conclusion

The Administration proposal thus fails to satisfy any of the criteria for evaluating socioeconomic tax measures. Containing as it does such blatant and serious defects, one may well wonder wherein lies the appeal of this and other excess profits taxation proposals. The answer can only be the immense appeal of such measures to the great mass of the American citizenry. As one author explains:

An excess of anything . . . is undesirable in the eyes of most people. It is not surprising, therefore, that the popular response should be in the affirmative when the abstract question is put whether there should be a tax on excessive profits. . . . Like "pay-as-you-go," the name "excess profits tax" is, to use the vernacular, a natural.⁶⁹

In the fifteen years ranging from 1955 to 1970, the domestic petroleum industry spent a total of 68 billion dollars on its efforts to find more petroleum. And it drilled a total of 653 thousand wells. For its efforts, the industry found 50 billion barrels of crude oil, 10 billion barrels of other petroleum liquids, and 296 trillion cubic feet of natural gas. In terms of energy value, the gas discovered was the equivalent of 88 percent of the amount of oil found. To have discovered enough oil and gas to satisfy all of the nation's needs during the period and also maintain a realistic inventory of proved reserves, the industry would have had to increase its drilling effort by 75 percent and spend an additional 50 billion dollars.

Id.; see also 1 INTERTECHNOLOGY CORP., THE U.S. ENERGY PROBLEM 55 (1971): "We conclude that, unless a new approach is created, utilities will not be able to generate the capital essential for the growth of generating and distributing capacity projected."

⁶⁴ Gueymard, *The Seventies—An Era of Transition for Petroleum & Minerals Financing*, 17 ROCKY MT. MINERAL L. INST. 557, 573 (1972).

⁶⁵ See note 4 *supra*.

⁶⁶ THE CHASE MANHATTAN BANK, *supra* note 1, at 46. The study sets the potential resource base for coal at nearly 800 billion tons—enough to last 1,500 years at the current rate of consumption.

⁶⁷ Gueymard, *supra* note 63, at 571.

⁶⁸ Like energy, capital is a resource—and it is also in short supply. The current shortage of energy reflects a prolonged shortage of capital—not the lack of an energy resource base. And that is a condition that must be corrected. If it is not, and the energy deficit becomes critical, we have only ourselves to blame.

THE CHASE MANHATTAN BANK, *supra* note 1, at 55.

⁶⁹ Rudick, *The Controversy over EPT*, 6 TAX L. REV. 121, 122 (1951).

Another writer underscores the popularity of such a measure:

[T]he average citizen is rather illiterate in the technical area of taxation and understands little about the inherent difficulties of an excess profits tax, which he is inclined to favor as a tax on profiteering that may lessen the need for higher taxes on his income or consumption.⁷⁰

The temptation, endemic in democratic societies since ancient Greece, to reach in times of crisis for the quick and superficially simple solution is strong, particularly if that solution contains the psychopolitical appeal attaching to wind-fall profits taxation. The magnitude of the energy problem demands that that temptation be resisted. Those now flailing the petroleum industry as the source of our nation's energy woes would do well to heed the warning voiced by an astute commentator:

The people of the United States must recognize that the problems of the energy industry require immediate action to avoid a developing crisis and that their welfare and the Nation's is at risk—not that of the energy industry.⁷¹

Tadeusz Marciniak

⁷⁰ Buehler, *The Problem of the Excess Profits Tax*, in *EXCESS PROFITS TAXATION* 3, 16-17 (1953).

⁷¹ Nassikas, *Energy Policy Imperatives*, 5 *NATURAL RESOURCES LAWYER* 627 (1972).