EXECUTIVE SESSION

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FRIDAY, OCTOBER 5, 1979

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United States Senate,
Committee on Finance,
Washington D. C.

The committee met, pursuant to notice at 10:25 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Nelson, Bentsen, Moynihan, Boren, Bradley, Dole, Packwood, Roth, Danforth, Chafee, Heinz, Wallop and Durenberger.

The Chairman: This committee will come to order, please.

Let me start out by saying that I had thought, and we had an agreement when we left yesterday, that we were going to come in here and hear a ten-minute statement on both side of the argument, at the conclusion of which we were going to vote on this Alaskan matter.

Senator Gravel is ill this morning and called in and said he was very sorry but he could not be here and he asked that the Alaskan matter go over until Tuesday and that being the case, I think that that is the only courteous thing we can do, and we should respect that request and that being the case, we had better try to find something else we can wrap up.

I would just as soon see if we can conclude the other part of this tax matter that we still have not gotten around to.

We have not settled the upper tier thing, have we?

Mr. Shapiro: No, it has not been settled as yet. As you know, you have a House bill with a 60 percent rate. You have had some discussion and you have had some votes on having a higher rate plus a phase-out. However, those amendments were not agreed to and therefore, you have not made any final decision on Tier II as yet.

Senator Dole has indicated his interest on having an amendment discussed at the appropriate time but as of now, Tier II has not been resolved by the Committee.

Senator Dole: I do not have any objection to doing that, except I think it may be somewhat tied to the action on what happens to Alaskan oil. Are there any other areas in the tax that we have not disposed of, other than upper tier?

Mr. Shapiro: The only ones are the net income limitation and we have a series of technical amendments.

Senator Dole: That income limitation is one that Senator Heinz has an interest in. Is that going to be difficult?

The Chairman: What is the net income limitation?

Mr. Shapiro: That just says that you will not have a windfall profits tax imposed on a property if they are not making at least 100 percent of taxable income. Let me give you an example.

Let's assume that we have a selling price of oil --

The Chairman: Could you put that on the board somewhere?

Mr. Shapiro: I think I can explain it. The concept is simple and Mike can put it on, if it is necessary.

Let's assume we have stripper oil, for example, when you are using a base price of $16 and the oil is selling for $22. The windfall profit element is a difference between the selling price of $22 and the bae price of $16, so we have a windfall profit of $6.

And, of course, the tax would be 60 percent of that, or $3.60.

Now, if the cost of that stripper property, for example, was $18 and the cost was $18 where the base price was $16, and that was the cost to get it out of the ground, then the net income of that is $4. The difference between the $22, which is the selling price, and $18, the cost, so the total net income, or the profit, is $4.

What the 100 percent net income limitation says is that, even though under the windfall profits tax formula, you would have a 60 percent tax of $6. Since you only had a profit of $4, you would only impose the tax on $4, not $6.

It is to protect against the high-cost properties where it cost an amount greater than the base price.

The Chairman: Please give me that again.

Mr. Shapiro: Let's assume you have a stripper property and you have a base price of $16. The selling price of that stripper is $22 and therefore, the windfall profit is treated as $6, the difference between $22 and $16.

Now, if it cost $18 to produce that stripper, then your profit is only $4, the difference between $22 and $18. The net income imitation says that the windfall profits tax, at a 60 percent rate, is imposed on $4 and not $6, because you can never impose the tax on more than 100 percent on the profit of the net income from your property.

That is the provision that is in the House bill and it is specifically provided to deal with the problem of the high-cost properties.

The Chairman: Well, now, that is in the House bill. Is anyone proposing to change it from that?

Senator Heinz?

Senator Dole: I think he mentioned he had an interest in net income limitation.

Senator Heinz: Yes, thank you.

On Tuesday, we did have a discussion of the net income limitation and I think Mr. Lubick understood some of the problems of the 100 percent net income limitation which is that it worked just as well as the 101 or 110 or 150 percent net income limitation, which is to say it would close down properties you do not want closed down.

And I think you suggested that we ought to have maybe a 90 percent net income limitation, on at least certain categories of oil.

Mr. Lubick: That was our solution to the stripper problem, as you remember.

The Chairman: Well, let me ask you now, would that mean that you would not tax the first 90 percent of that cost but you would tax the other 10 percent of that cost?

Mr. Shapiro: What it means is that the tax could not be more than 90 percent of that profit.

The Chairman: It would not be more than 90 percent of their profit?

Mr. Shapiro: That is the base. Let me give you the example we were using.

The example we were using was a $4 difference, an $18 cost and a $22 selling price, so a 100 percent limitation means that you cannot impose the windfall profits tax on more than $4. So if you have a 60 percent rate, the tax could not be more than $2.40.

Now, if you imposed a 90 percent limit, you would just take that $4 and multiply it by 90 percent to reduce the amount of the base on which the rate would be imposed.

So if you had no net income limitation you would have a 60 percent rate on $6, the difference between $22 and $16. If you have the 100 percent net income limitation, then you would impose the rate of 60 percent on $4, because the 100 percent net income limitation would apply.

Senator Heinz: I think you had better go through that one more time.

Mr. Shapiro: Mike is putting an example on the board, too.

Senator Heinz: That would be really helpful.

The Chairman: Let me see if I understand this.

Assuming that this fellow had $10 profit, and assume that all of his net profit would be subject to the tax, and he had $10 of profit, well, then, if I understand what the Senator is saying, that you would only apply the tax to $9 of his profit and he woud then be able to keep $1 of his profit?

Is that right?

Mr. Shapiro: It is a limitation --

Senator Heinz: I do not know about the Chairman's suggestion, but as I understand the way the House bill works out net income limitation, the tax operates but there is kind of a, if not a floor, a sub-basement stratum that keeps the tax from taxing every bit of income, income taken to mean what is left after windfall profits tax and in the case of an individually owned, or a partnership, individual income rates and in the case of corporation, after tax of corporate rates.

Is that the way that operates?

Mr. Lubick: As I understand it, this is based on a per property basis for the year, so you have to, I think, apply the tax immediately for the withholding and then the particular person affected would have to make a computation and if his costs plus his taxes from the property exceed his revenues, he would get a refund of the tax to that extent, to bring it down to break even.

Senator Wallop: Could I maybe take a shot at explaining what I think it does?

You have a base price, whatever it is, that gets established ---and that, I assume, is still an argument that is left in front of us. You have a selling price and the difference between the base price and the selling price is the amount that the windfall profits tax is assessed upon.

If your costs of production are higher than the base price, you are not taxed on the differential between the base price and the selling price, but the differential between the cost of production and the selling price.

Senator Bentsen: Well, if that is the case -- and that is what I thought it was -- then why is the 100 percent a problem?

Mr. Shapiro: I do not think anyone is saying that the 100 percent is a problem. There are some suggestions that you should go 90 percent, which means it is more favorable than 100 percent.

Senator Bentsen: I understand that.

Mr. Shapiro: I do not know if anyone is questioning the 100 percent as being a problem.

Senator Bentsen: You skew, then, the percentage tax that you are applying if you start going back and saying well, we are not going to tax all the profits. We are going to tax 90 percent of the profits.

I just really do not see the problem with 100 percent, as long as you are only taxed on the profit that you are making.

Senator Wallop: I think that that argument can be made, but if you are, indeed, in a property that is the cost of production up and above the base price of say, $16 or $18, you are really being pinched, even so ---even more so than other producers would be by the tax, just in terms of net income from the property

The Chairman: Maybe you can put that up there where we can see it better, because I will have to admit that I do not realy understand how this thing works.

Would you mind reading that off the chart and explaining how that works?

Mr. Shapiro: We are assuming we have a stripper property where, under the House bill it is Tier III, and that means it gets a base price of $16. We are assuming that same stripper oil actually sells for $22.

Therefore, to compute the windfall profits tax, we take the selling price of $22, subtract it from the base price of

$16 and we get a windfall profit of $6.

The Chairman: Now, but after that happens, he is still subject, is he not, to the individual taxes and the corporate taxes?

Mr. Shapiro: That is correct. We are only talking about the windfall profits tax at this point.

The Chairman: That does not mean that he keeps the $2.40 and you tax it again after that, but at least at that point he has got $2.40.

Mr. Shapiro: Let me also say that we are also simplifying this example by not including severance taxes or any other royalty payments that may have to be made. We are just talking about a simple example to illustrate how the net income limitation works.

So you have $22 minus $16, so you have a $6, which is a so-called windfall profit. Then on the righthand side of that, you see that the tax equals the $6 times the rate, the windfall profit rate of 60 percent, so under the House bill, that particular stripper property would pay a tax of $3.60 on that barrel of oil.

Now, we make another assumption and that is that on that particular property it costs $18 to extract that oil, so the costs are actually greater than the base price, and that is the problem that would occur, the potential abandonment of the property, if the costs get up so high that you have a windfall profits tax imposed on top of the income tax, then you may have potential shutdowns and abandonments.

So a provision to try to limit that problem would be to have the so-called 100 percent net income limitation to impose the tax on the lesser of the actual profit, or the base.

In this case, we find that when you have an $18 cost, you have a net income of $4, so you have a windfall profit of $6, a net income of $4.

So in this case, you impose the 60 percent tax on the net income rather than in the windfall profit.

So, as you see, the tax is $4, which is the actual profit times 60 percent and therefore, in this part, you have a windfall profits tax of $2.40 rather than $3.60.

Senator Heinz: Let me ask the Treasury if they know what the different costs between a 100 percent and 90 percent limitation would be?

Mr. Sunley: Mr. Heinz, we do not have a specific number on that, but it is not very great.

Senator Heinz: Not very great?

Mr. Chairman, if it is not very great, it seems to me it is just smart to go with the 90 percent since we are going to get more production as a result and any time we get more production for no cost, it is a good deal.

Senator Bradley: How much more production will we get?

The Chairman: Well, you have got to keep in mind that after the man get his $2.16 he could be paying an individual income tax of as much as 70 percent and so it could very well be that all he really has is 30 percent, so it might very well be that all he has really got to show for it is 60 cents on a barrel of oil selling for $22.

Now, you do not really have to tax 100 percent of it away to so demoralize a taxpayer that he just gives up. I think someone made the point around here that after all, your time is worth something, you know, and the time you spend fooling around with something like that.

And so that really, I think, by doing that, the government would gain more than the taxpayer would, because when he shuts the well down, you do not get anything out of it.

Mr. Lubick: Mr. Chairman, I would like to point out that in the determination of costs here, an allowance is made for hypothetical depletion of the intangibles that had previously been expensed, so there is cash flow here that is beyond the amount that is claimed as deductions in the cost.

The Chairman: But you and I know, Mr. Lubick, that -- and I think that your view on this thing is a lot more sound than some of your predecessors over there in the Treasury -- and that is that you and I both know that that intangible drilling expense is a mere deferral.

In other words you are entitled to write off those intangibles, it is just that the break you get is that you can write them off in the same year you incurred them, and so that that intangible drilling expense is something that tends to run out on a guy. It is a break, but at the same time, it is not the kind of break where you just get something without a condition to it. You deduct an expense in the year you incur it rather than capitalize it, but you lose what would have been your deduction later on.

Mr. Lubick: I was not talking about the merits of that particular question, but rather dealing with the question of incentives to lift or cap, and there is a margin in here of cash flow return to the operator of the well, because in addition to his actual expenses in determining his net income limitation, a deduction is given for costs which had been incurred many, many years before on a hypothetical basis and which are not actual costs in calculating.

So there is some additional margin here to prevent the problem which you are conce ned about.

The Chairman: All right.

Do you care to be heard further on that matter?

What is the revenue impact of the Heinz suggestion?

Mr. Shapiro: At a 90 percent level, we do not have an accurate figure, but we do not think it would be very large.

The Chairman: Well, could you give us some guess, a ballpark guess, just something that you could grab out of the air?

Would you call it de minimis?

Mr. Lubick: Probably a few hundred of million over the period of time. It seems to be more of a problem with the old oil than with Tier I oil and others.

The Chairman: Well, those in favor, then --

Senator Chafee: Mr. Chairman, I would just like to ask Treasury here, what are the problems involved in the accounting here? Is this a simple matter that the IRS follow is clear-cut, what costs are attributable? Can we say that this oil costs $18 a barrel to produce?

How do yo do this?

Mr. Sunley: Senator Chafee, there are clearly some problems. As you remember, the tax is imposed, essentially, on the first purchaser, and he obviously does not know whether the property has a net income or not, so that in effect the House bill, as I understand it, the tax is paid and then the individual producer has to file for a refund and claim a credit if this limitation applies and he gets the money back.

And obviously the more generous we make this net income limitation, the more people will be filing these returns.

We think, however, that at the moment you have exempted from the tax most of the high-cost oil. The heavy oil has been exempted, incremental tertiary has been exempted. We have got the big exemptions into the high-cost oil, so that most of the oil which is produced which is subject to the tax, was being produced under controls, and it was profitable to produce it then ---that is to say, the additional revenue was greater than the cost of lifting the oil, so that we think that it was probably still be profitable to produce it after the price is gone up.

So not only does the price go up, but the cost of computing the net income limitation takes into account, as Don pointed out, cost depletion, which provides, you know, a margin here.

We think that the administrative problem can be handled, I think, but you are right, it does require taxpayers filing and claiming the refund.

The Chairman: Let me try to put it from the taxpayer's point of view. From the point of view of the taxpayer, the simplest thing is not to pass the tax -- that is the simplest thing. Just do not pass it at all. Forget about it.

But if you are going to pass the tax, with all the regulation that has been imposed on the fellow from DOE, for example ---a fellow came to see me awhile back and say, well, he had an operation. He had 50 employees and he has had to add three of them to work exclusively in trying to fill out all the forms and do all of the DOE things and comply with all the government regulations.

So I would think that, from the point of view of taxpayer, he is going to have to hire additional help to try to comply with all the complexities of Federal regulation and Federal taxes anyway and that being the case, I think he would say that if you decide to give him a break somewhere along the line, he could find the technical competence to comply with it.

Yes?

Mr. Sunley: Let me add, Mr. Chairman, that the concept of net income here is an old concept. Essentially it goes back to percentage depletions. The Internal Revenue Service and the taxpayers know what we mean by the net income from a property. That is a longstanding tax concept, and I think I would agree with the Chairman that we have less trouble with taxpayers about the complexity of the tax law if what is involved in a refund for them.

Senator Dole: Is it any more complicated than 90 percent or 100 percent?

Mr. Sunley: Only more complicated in the sense that there will be more situations where this limitation will apply.

Senator Dole: More people might comply if you explained the reason.

The Chairman: It is more complicated to multipy by 9 than it is by 1.

Senator Bradley: Mr. Chairman, do we know if there is any particular place or category that has oil that is much more above a base price? This applies only to upper tier, is that correct?

Mr. Shapiro: Are you talking about the net income limitation?

Senator Bradley: Yes.

Mr. Shapiro: It applies across-the-board, to all categories.

Senator Bradley: It applies to all categories, so that yesterday in the slide show that we had on Alaska, if you assume a base price of $13 -- which is what the administration wants -- if you can show that the costs are up to $20, then for Alaskan oil the taxable profit is $2. Is that the way this would work?

Mr. Shapiro: Well, it depends on what the selling price is. You see, Alaskan oil --

Senator Bradley: Well, assuming $22.

Mr. Shapiro: But they are not getting $22. In other words, it may be selling for $22, but you subtract the transportation out, so the Alaskan oil right now is really not selling for much more than its base price. In other words, that is actually what the operator-producer gets.

The problem is that no refiner is going to pay more for Alaskan oil than they will pay for imported oil. The world price is $22, so they are actually paying $22 for Alaskan oil.

However, the transportation costs are included in that, so actually the operator will only get the difference between what the refiner will pay less the transportation costs.

So the producer will only get approximately $13 for that oil today.

Mr. Lubick: Hypothetically, you are right. If they got $22 and had costs of $20, then you are correct.

Mr. Shapiro: The concept you are getting to is absolutely right. That is the way it would work.

Senator Bradley: And you do not have any analysis as to what this impact might be, and why do you say it is de mimimis, $200 million or $300 million?

Mr. Lubick: Because there are not very many instances after the exemptions that have been adopted where you are going to have costs that are going to come that close to the selling price.

Senator Dole: Some will make a profit?

Mr. Lubick: Yes.

Senator Dole: We ought to take care of that. I do not know whether they should be allowed to make a profit or not.

Senator Heinz: If the Senator from New Jersey is worried that this is bringing some huge loophole here, I would assure him that that is not my intention.

Senator Bradley: I was just trying to figure if there were any people in New Jersey who could squeeze in here.

The Chairman: Well, Senator, if you have somebody up thee who would like to get in the stripper oil business, I think I could find you a lot of folks in these producing states who would be glad to have them as partners. That is not the kind of well most people are looking for.

Well, all in favor of the amendment, say aye?

(A chorus of ayes)

The Chairman: Opposed, no?

(No response)

The Chairman: The ayes have it.

Now, can we settle some other things here? If there is anything we can settle, let's get them settled.

Mr. Shapiro: Okay. If you want to put off Alaskan, as you have already decided --

The Chairman: Well, we have to because Senator Gravel had a very great interest in that matter.

Mr. Shapiro: If you want to wait for Tier II with Alaska, then the only thing that we have left are some of what we call technical provisions, but let me be very fair and say some of them have some substantive effect, but they are just not of the magnitude of some of the decisions you have now, but they do have some substantive effect and do rearrange some of the administrative provisions that you have got.

We have distributed them to all of you on October 1. We wanted the staffs and others to take a look at these for the week and we have been discussing these with members in the industry so they would fully have an opportunity to see what we are recommending as modifications and also see if we can get some others that they may be interested in for us to review.

I can just go through them. They are only about four or six of them. They are not that many.

Senator Wallop: Mr. Chairman, before we do that, I would just like to bring up a proposal that I will make at the time when we have settled on how much tax we have and other things, for a phase-out that will not cost anything to the tax.

I see Senator Heinz laughing, but all of the other proposals have had a net reaction on the overall amount of money that was to be raised by this and I know that the Treasury's position is that there should be no phase-out, but if there is to be one, what we would do would be to, at the time that we get to either 85 percent or 90 percent of the total revenues that have been authorized, or have been selected by the committee as the amount of the tax we would require, we would then phase out the tax at the rate of 3 percent a month, which would be 33 months. But what we would actually do is we would probably end up with 110 or 115 percent of the amount the Committee selected as the tax that it wanted to levy.

If we are going to phase it out, this way we do not have the revenue loss projections that have been associated with other phase out proposals that are automatic. This way if it takes us until '89 to get all the money, then it is 33 months from '89 which goes into '92. If it happens to be in '86 that we achieve that 90 percent figure, then it will be '89 by the time the tax is all gone, but it will have achieved the goals that the Committee has selected, at no cost to revenue.

The Chairman: Is there any discussion on that?

Senator Moynihan: Mr. Chairman, there certainly is going to be some discussion on that. May I first of all ask, sir, did we adopt this last exemption without a roll call vote? Should we not have a roll call.

The Chairman: The 90 percent?

Senator Moynihan: Yes, sir.

The Chairman: Yes, sir, we did, by a voice vote, but I would be glad to have a roll call. Would you like to have a roll call on that?

Senator Moynihan: Are there are others who would like to have a roll call?

The Chairman: Let's call the roll. We are voting on the Heinz motion which we had just discussed at some length to apply the windfall tax --

Mr. Shapiro: A net income limitation of 90 percent on the windfall profits tax.

The Chairman: Right.

Yes, sir?

Senator Danforth: Does the admnistration have a view on it?

Mr. Lubick: Well, we had suggested that something like that might be appropriate to deal with the high-cost properties and we think you have dealt mainly with the high-cost properties through your exemptions, but the dollar amount is not consequential and it is just not a very big deal.

Senator Nelson: The question I was asking Mr. Heinz when the Chairman called for the roll call, was how does it apply in a situation where the base is $18 but the owner has a cost basis of $14.

What happens?

Senator Heinz: In that case, he is not up to the 90 percent, so that nothing would happen in that case. In other words, 90 percent of 18 is 16.2 and so -

Senator Nelson: I thought you applied the 90 percent to the profits side. In your example, you are talking about a $4 profit.

Senator Heinz: It is applied to the net profit, so the costs are relevant.

If the cost is below the base price, the limitation does not apply.

Senator Nelson: It only applies, in that case, when the cost is above the base price?

Senator Heinz: Is that not right?

Mr. Shapiro: No, that is not exactly right.

If you had a 100 percent limit, that woud only apply in cases where the csots exceeded the base price, but it is possible when you go down to 90 that there will be some cases where the costs are slightly less than the base price where the 90 percent will kick in.

Let's suppose the costs here were, instead of $16, were, let's say, $15.50, so the profit --

Senator Nelson: Why not make it $10, go way down?

Mr. Shapiro: Then it would not apply. I am trying to show you the case where a 90 percent limit kicks in and a case where property is still profitable and, let's say, at $15.50, your profit would be $6.50, your limit would be 90 percent of $6.50 and that could turn out to be a smaller figure than the $6.00 windfall profit that would be taxed under the House bill.

Let's take a case of -- you see, if you are taking 90 percent of the net income, so if your costs are slightly under $16, the 90 percent figure will cause the net income limit to apply in a case where the costs are, in fact, slightly less than the base price. That is why the House went to 100 percent instead of to 90 percent.

Senator Danforth: Can I ask what is included?

Mr. Shapiro: Well, the base price is price of selling under controls as of the date the program was announced. It is adjusted upwards.

Senator Danforth: The high price is the price that it is being sold for.

Mr. Shapiro: That is the selling price.

Senator Danforth: The low price is whatever the base price i for the windfall profits tax -- that is, when you you total up the cost to find out whether they exceed the $16, what do you total up?

Mr. Shapiro: In the House bill, the costs are essentially the same sort of income concept that the companies would report to their shareholders. In other words, there is no percentage depletion. Intangible drilling expenditures are treated as if they were capitalized and written off over the life of the well rather than expense, so it is sort of a -- it is the same income concept that they essentially use in reporting to their shareholders, rather than taxable income for tax purposes.

Senator Danforth: Does it include state taxes?

Mr. Shapiro: Yes.

Senator Danforth: If a state were to increase its taxes on oil companies that would effectively offset?

Mr. Shapiro: That would count as a cost, Senator Danforth. So to the extent that the states were to increase their costs, Federal revenues from the windfall tax would be reduced?

Mr. Shapiro: you see, if you stated a 100 percent limitation, then the only way it would kick in is if the states increased their taxes to the point where the property actually would be losing money which they probably would be reluctant to do.

So I am not sure that that would be a very serious problem.

The Chairman: Well, actually, in taxing these kinds of wells, the states go easy on them just like it is being suggested, go easy on them here. For example, we do not tax these stripper wells as heavy as we tax the good wells.

Mr. Wetzler: If there is a problem with Senator Heinz's amendment, it would only become apparent if, let's say, the price went up to, say, $50 a barrel. So for a lower tier property, it was getting a price of $50 and a base price of $6. It would be paying a very large windfall profits tax under the House bill. Your 90 percent limit would sort of limit that windfall profit to 90 percent of its income, so it might be, let's say, 90 percent of the $45 figure as opposed to 100 percent.

So it is really --

Senator Heinz: Would that be on the lower tiers?

Mr. Wetzler: Yes. That is where your limit is more likely --

Senator Heinz: But does it not phase out at the lower tier within three or four years?

Mr. Wetzler: Yes, but the OPEC may phase up the price faster than we phase out. It is just hard to say.

That is the case where your amendment might end up losing some revenue, is if the price goes way up and so that 10 percent you are giving them is 10 percent of a very large net income figure and that, I think, is --

Senator Wallop: But that is not an assumption we are making in any other instance when we are --

Mr. Wetzler: No. That is why we are saying, under our assumptions, we are expecting this not to have a very large revenue impact.

Senator Dole: There is not any reason

The Chairman: Well, should we call the roll on it? Let's call the roll.

Mr. Stern: Mr. Talmadge?

Senator Talmadge: Aye.

Mr. Stern: Mr. Ribicoff?

(No response)

Mr. Stern: Mr. Byrd?

(No response)

Mr. Stern: Mr. Nelson?
Senator Nelson: No.
Mr. Stern: Mr. Gravel?
(No response)
Mr. Stern: Mr. Bentsen?
Senator Bentsen: Aye.
Mr. Stern: Mr. Matsunaga?
(No response)
Mr. Stern: Mr. Moynihan?
Senator Moynihan: No
Mr. Stern: Mr. Baucus?
(No response)
Mr. Stern: Mr. Boren?
Senator Boren: Aye.
Mr. Stern: Mr. Bradley?
Senator Bradley: No.
Mr. Stern: Mr. Dole?
Senator Dole: Aye.
Mr. Stern: Mr. Packwood?
Senator Packwood: No.
Mr. Stern: Mr. Roth?
Senator Roth: Aye.
Mr. Stern: Mr. Danforth?
Senator Danforth: Aye.
Mr. Stern: Mr. Chafee?

Senator Chafee: Aye.

Mr. Stern: Mr. Heinz?

Senator Heinz: Aye.

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: Aye.

Mr. Stern: Mr. Chairman?

The Chairman: Aye.

Eleven yeas and four nays. The ayes have it. We will let the absentees record themselves, but that would not change the result.

Now, what else do we have that we can --

Mr. Shapiro: There are two major issues you would take up on Tuesday, which is Alaska and the upper tier and what has just been passed out to you are a series of administrative type provisions. Some of them are technical, but some of them do have a revenue effect, so I do not want to call them just technical, and there are just a few of them, so we can go through these now.

Senator Nelson: Mr. Chairman?

The Chairman: Yes, sir.

Senator Nelson: I have one that I have been waiting for to get to bring out. It is a bill introduced by Birch Bayh. It is some changes in the law that are necessary if you are going to use gasohol. The staff looked at them and could we take those up now? I think we could settle them in three or four minutes.

Mr. Shapiro: Senator, what the Committee agreed to earlier are that all provisions that deal with situations other than windfall profits tax be dealt with on the reconciliation and that is on the list that the staff is instructed to bring back to the committee.

Senator Nelson: All right.

Senator Roth: Could I just ask the Chairman a question before you get into your proposal?

Senator Nelson: They are going to bypass this until later, anyway.

Senator Roth: Mr. Chairman, looking down the road, as you know, I intend to offer some tax proposals, one on Social Security, and I wonder what would be the appropriate time? I would like to have the opportunity to do that prior to the reconciliation, because I think it is a fact that ought to be considered so that could I look forward to offering that Tuesday or Wednesday morning, or when would you suggest?

The Chairman: Well, I had suggested that we try to get through what we have got here on this list before we get around to the other things and I thought we had an agreement with that, and I would hope that we would go ahead and get through the items that the staff has down here.

Now, we had covered most of this, but I had hoped that we would get through this list. This reconciliation, I thought, would be the first thing to come back in by the time we get to the end of the list.

But let me ask you, why does the Senator want to offer the amendment before we get down to the reconciliation? It would seem to me that we get the reconciliation and then we would see how much money we have got left?

Senator Roth: Well, because I want to make certain that all the funds are not reconciled prior to my proposal.

The Chairman: Would you mind explaining that? Senators have all got their plans and I admire them for it. It shows they have active minds -- not that it gives me problems -- but I would like to think that everybody here has a little imagination and can come up with a new idea now and then and so it is fine with me when Senators come up with these proposals and they certainly have a right to.

But could I ask just what is the logic to that, because I am trying to figure out just what the Senator has in mind?

Senator Roth: Well, as you can appreciate, that any proposal we have will have an effect on revenue as, of course, the decontrol will affect -- we have not only the windfall taxes, but we also have the additional taxes that will result in the corporate income tax area, and I want to be in a position to offer my tax proposal on a financially sound basis.

It seems to me you are talking about reconciliation. We could end up using every dollar that we have, not only in the windfall tax, but in the additional corporate tax.

I just want to make certain that my proposal can be given serious consideration.

The Chairman: That is fine and I will try to cooperate with the Senator. I just wanted at least to see that he had the opportunity to offer his amendment.

I just want to make this point clear, that the way I understand it -- I want Mr. Shapiro to hear this, because he knows about what this overall problem is -- and the way I understand this thing, and I will ask Mr. Shapiro if this is correct -- if you look at that Budget Resolution and it seems to me that that seems to imply that we in this committee have the burden of raising the money, not only to pay for that we are recommending to the Senate, but to find money to provide the other committees in the area of their jurisdiction for them to do things, and therefore that if we bring out a bill which as we suggested we would like to do, that we thought we ought to, to bring out a bill where the money we raise is used in energy areas, in encouraging production and conservation in the areas of our jurisdiction, and we use up all the revenue we raised, that the other committees are not willing to go along with that and that the Senate has more or less taken a different view, and that we are under the burden of raising $2 billion, a substantial portion of which should be from this bill to raise the money to pay for these things that fall within the jurisdiction of other committees on the spending side.

Is that correct, Mr. Stern? Do you people understand that?

Mr. Stern: There was an amendment on the Senate Floor to change the revenue figure to zero and that amendment was defeated on the budget resolution, so the Senate more or less has taken the position that whatever this committee raises, $2 billion should be available for what other committees are going to do.

The Chairman: So if we come out of here with what we would like to have done to the Committee is a bill that provides taxes and provides production incentives and conservation incentives and all the different things that we are talking about here, that are within our jurisdiction, if we come out with a bill that spends all the revenue doing that, even including a tax cut, we can anticipate that the Budget Committee is going to tackle us and that the Appropriations Committee would take us on and that the Energy Committee would jump us, all saying that we had the burden, under that Senate Budget Resolution, to provide funds to be used in areas of their jurisdiction. Now, can I anticipate that that is what we are in for if we come out that way?

Mr. Stern: Yes, sir. The House assumes a higher revenue figure, so it is not likely that you would emerge from the conference on the Budget Resolution with anything lower than $2 billion.

The Chairman: Yes, sir.

So I just want the Senate to understand the problem that I face, and the Committee faces.

Senator Roth: Mr. Chairman, I understand and appreciate the problem. Frankly, I regret that the Senate did not follow the advice of our Joint Economic Committee and provide for tax relief now, as many of us think is accurate, but I realize we have to work within the restraints of what the Senate did.

My proposal would not affect 1980. It looks down the road. That is an issue that came up last year and, thanks to the leadership of the Chairman, the Senate ruled that we could take certain action. I have certain proposals I intend to make with respect to Social Security at that time.

Senator Danforth: Mr. Chairman?

The Chairman: Yes, sir.

Senator Danforth: Sometime next week I would like to raise the question of the exemption of state and local governments. I have mentioned it before and my understanding is there is some legal memoranda being written on the subject on both sides, so I do not think it is ripe right now, but I did want to just raise it again at this point.

The Chairman: I would like to ask our staff -- I had not done this, but I would like to ask our staff to get us a memoranda on that subject, on that issue of taxation of state and local governments. There is quite a bit of jurisprudence on this subject and we ought to have it available to us when we discuss the issue.

Senator Danforth: I would hope Treasury would do the same, or anybody else who is interested.

Senator Bentsen: I assure the Senator that some work will be done on the issue.

Senator Nelson: I wonder, Mr. Chairman, who is doing the legal work on it? I am told that the Supreme Court was divided on the question and I am told that there may be the possibility of a lawsuit in this case. I would like to have a legal opinion on the question to find out if we did pass it are we in a lawsuit that ends up going to the Supreme Court. Do you know anything?

Senator Danforth: I think it is fair to say, from what I know of the law -- which is not much at this point ---that there are two sides to the question. I think, and I will argue, that the weight of the law is in favor of the application of Federal excise taxes to the state.

But I think really the question that we will have to face is going to come down to a matter of policy since the law could be argued on both sides, and since some $6.5 billion of revenue is lost by this exemption, it will be my argument, at the appropriate time, that the opportunity of $6.5 billion of revenue is certainly worth a little bit of legal expense going to the process of litigation.

Senator Bentsen: Mr. Chairmn, I assume we are not going to be debating this this morning, but I do have to respond to that remark.

First, I do not think we are going to be talking about any $6.5 billion because I do not think credit has been given in these numbers to tertiary and to heavy oils which should be a very major portion of it, so I think we are talking about less money than that. We have a very major question of invasion of state rights.

The Senator, when he speaks of the constitutional question, I think we will find that the preponderance of the cases say that the Federal government can tax -- if you are talking about something akin to a commercial venture being brought by a state, but royalties are defined as property and when you get to a question of passive income and it is coming from properties, then you have quite a different set of decisions by the Supreme Court and you find, I believe, that the courts will be quite clear in saying that cannot be taxed.

So we can debate this issue when the Sentaor wants to bring it up.

The Chairman: Well, we will in time and I thought we more or less had a tacit understanding that this would be brought up at the end rather than right now. I am not precluding it, but I thought we had sort of a tacit understanding that it would come up later on.

Senator Bentsen: I would just ask the Chairman that because of my deep concern on this particular issue, and it being such a major, fundamental change, I believe, if this Committee would do it, that I would like very much to be here when that is discussed and I will make every effort. I would just like to know ahead of time.

The Chairman: I hope the Senator will be.

Now, what else do you have there that we can -- what is this point that you are talking about, this administrative point?

Mr. Shapiro: The administrative provisions. You have materials that the staff passed out that I think were just distributed to you dated October 1. There are a series of administrative type provisions. There are some of them -- the first one, for example, has a very large revenue effect, but staff is recommending of it because of problems in the House bill that were not focused upon until subsequent to that time and the revenue is really only in the first fiscal year.

Unfortunately, that is the one that has a problem with the budget. The reason is that it just shifts it from one fiscal year to the other.

The heading would be the tax returns, tax deposits, information exchanges and penalties. Under the House bill, in general, information returns, tax deposits and so forth are under the Secretary's regulatory authority. The bill generally requires that the first purchaser pays the tax and it is paid on a semi-monthly deposit basis.

Actually, the way it works is that the operator of the property certifies to the purchaser all the necessary information. The problem that developed is that we found out that having semi-monthly payments are too fast, because many times the operators do not have the information that is available to get it to the first purchaser. Typically what we mean here is a producer is the operator, the purchaser is generally a refinery, so the tax for administrative convenience is imposed on the first purchaser, which is the refinery.

Now, when we say that you pay it semi-monthly, that is twice a month. We have since found out that the infomration just is not available then so it is just something that will not be able to be done.

A suggestion staff is making is to provide that the tax is paid by the first purchaser who would make the deposit 30 days after the end of the month and it would be 60 days in the case of independent refiners. Independents generally have more of a cash flow problem and in many of the other cases you have a major oil company buying from a lot of its own production.

The Chairman: Now, I do not want to lose a lot of revenue that we do not have to lose, especially for budgetary purposes.

If we do the kind of thing you are talking about, does that not lose us a lot of revenue?

Mr. Shapiro: Unfortunately, it does. We understand that part of that was taken into account when the Senate and House Budget Committees went to a lower revenue estimate.

For example, the House bill was about $2.8 billion and you went to $2 billion, which is what they wanted to raise. They took into account that some of this reduction represented a payment problem, that it could not be made and it would be pushed back.

So that is what we understand was taken into account by the Budget Committees.

It is a pretty large figure. In other words, it is not lost revenue. It is shifting it from one fiscal year to the next. It is not changing the tax, it is just recognizing that there is a problem in that you are imposing the tax on the first purchaser. You are not imposing the tax on the producer, but the tax is paid by the first purchaser and it does not seem fair to have the tax paid, as administrative convenience, by purchaser when it is really imposed on an operator-producer, but it is being paid by the first purchaser and that first purchaser does not have the records and does not, many times it is even a cash flow problem for that first purchaser.

The Chairman: Well, I do not know why we cannot impose this tax on the person who is really paying it. In other words, the person who is really paying it is the producer, right?

Mr. Shapiro: The reason for that, Mr. Chairman, is that you have several thousands of producers and only hundreds -- and in royalty holders you have maybe hundreds of thousands -- so between thousands of producers and hundreds of thousands of royalty holders, the administrative problem of having a collections process for all of those could be simplified by having the tax paid by the first purchaser because you only have several hundred that are the refiners, and most of them -- it is just that it is some of the major refineries, or not even a hundred of those, but you reduce the administrative process from hundreds of thousands to just a couple of hundred, and major ones would be less than 100.

The Chairman: Well, my thought about this is in most instances, is it not true in most instances it is the operator who is -- is it the operator or first purchaser who is sending those checks to the royalty owners?

Mr. Shapiro: As we understand it, typically the purchaser will send the checks to the royalty holder.

The Chairman: And that is who it is that you want -- in other words, under this tax is the first purchaser to withhold and to remit to the government, or is it to be that the producer withholds and remits?

It is the first purchaser, right?

Senator Dole: Which is the refiner.

Mr. Shapiro: In almost all cases it would be.

The Chairman: Well now, why can he not -- when he is buying this oil, why can he not just withhold and make the payment over to the government?

Mr. Shapiro: That is the way the House bill works.

The Chairman: Well, it would seem to me that if you cannot do any better, you could have him withhold on some basis and then do his final accounting later on, pay us some part of it, which is clearly to be our part, just like they do with the withholding. When you withhold you withhold and then you remit it later on.

That is, you settle up at the end of the year.

It seems to me that -- well, look how you do withholding on a working man salary. He is billed in a certain form and then you just come up here with a withholding. I want Mr. Lubick to hear this now, because I want to get the money in this fiscal year, if I can, and Treasury ought to share that objective, to get it just as soon as you can get it. That is how most tax collectors are, and if you are worth your salt, you will be that way, too. Do you share that sentiment?

Mr. Lubick: I share that sentiment, Mr. Chairman. I have expressed it here many times, I believe.

The Chairman: Here I am trying to help you get your job done and so even though it is my constituents who are paying, it seems to me that you ought to try to get your money as quick as you can. The longer you leave the money in the taxpayer's pocket, the more he likes to think it is his, and therefore, if you have got to pay it, the sooner we get it over with the better off we are going to be.

So that you people have come in here with proposals for withholding on interest and withholding on dividends, well you say, look, withhold a certain amount of it and we will settle up later on, and it seems to me that you ought to start right out on some basis just withholding of what the approximate amount is going to be and then getting down to the fine calculation later on.

Can you not do that?

Mr. Lubick: It can be done, Mr. Chairman. The question that was raised with us by the persons involved was that they might, in some instances, have to borrow money to make the payment.

The Chairman: Well now, here is what tends to happen in this business. People go together and they drill a well and then, after awhile, they sign a division order and their lawyers all check it out and everybody is sure he is getting his exact, right percentage, and all that type of thing, and then at that point, they send them a check for their share of it.

Sometimes it is months after they start selling the oil before they get their money because of passing the division all around to a lot of royalty owners and all of that. But there is no reason why the person who is purchasing that oil has to wait until they get through with al that. As far as Uncle Sam is concerned, he can send Uncle Sam his check right here and now because, in any event, those royalty owners are not going to be permitted to keep that money.

Senator Dole: But the refiner does not have the money until he sells. I think that is --

The Chairman: Well, but he does. I mean, as I understand this, the sales are going right on. He is running it through his refinery. He is selling it to the public.

One thing these big oil companies love and that is have all this money sitting around drawing interest for them while somebody works out the division orders and all that kind of thing and while the lawyers check things out, and all of that. To the extent that you are leaving this money in these people's hands when they could have sent it right on in, you are losing the interest money and they are making it. Is that not right?

Mr. Lubick: Well, that is correct. I think it may be further up the line that the problem comes. There have been arrangements for deferred payments and some people may be caught in the middle having received the money from where they are getting it.

I think that is what the problem generally is.

Mr. Shapiro. You see, what generally happens is, they may buy the oil but they have a contract which has a deferred payment, so even if they may buy it from day one, they might not actually pay for it until 30, 45, 60 days later.

Mr. Lubick: If everybody paid cash, you would not have the problem, but when one person has extended credit --

Senator Dole: It takes a while to produce a product and sell it.

Mr. Shapiro: Mr. Chairman, you are concerned about the budget problem. Let us make a suggestion which may take a way out of it that may cause certain inconveniences that --

The Chairman: Now, as far as most of this money is concerned, most of this money is going to come to us by way of these major oil companies. Is that not right?

Mr. Shapiro: That is correct.

The Chairman: Now, those people are not hard up for money these days and they could pay it right on through. Now, I cannot blame them for wanting to hang onto that money as long as they can because they can make interest on it, but we need that money in order to meet our budget problems right here in this committee and in order to meet the Budget Resolution, we need the money. We need it as soon as we can get it.

And that being the case, I would feel that we should not leave with those companies money that they can be paying on through just on some basis of convenience. For example, why on earth do you need to leave the money with Exxon while they are doing some paperwork?

Let them go away and pay most of the major part and then get down to fine figures later on. They have accounting offices as good as the government has -- maybe better.

Mr. Shapiro: Let me make a suggestion, because I understand the point you are making. What if you, as far as the majors are concerned, keep the rule the way it is in the House bill and we would have to put together some type of --

The Chairman: They have got the money right in their treasury. They can send you the money right now.

Mr. Shapiro: It was not the money as much as ---the money factor was a concern of the independent refiners. The problem with the majors is the information was not there.

Let us put together a modification for having some estimating procedure for the majors and having an even-up process later. I think it is a significant problem with the independents. Those are the ones that have really come to us and raised their concern.

The Chairman: Now, if we can take care that where the government is getting about 75 percent of its money right off the top and then we have to give them a little more time for the other 25 percent, that might be fair. But as far as the major companies just having the money sitting there, well, they are not hard up for cash the way it is now. It just seems to me that we ought to tell them to bring it on in here.

Now, a failure to do that puts us in difficulty on our end. We are trying to meet budget requirements here and I think that, to the extent that they are in a position to remit ---and I think that they are ---it helps to solve our problems.

Mr. Shapiro: What you are suggesting, then, is as far as the majors are concerned we will keep the provision for semi-monthly deposits in the House bill but we will put in there an estimating process that they will make in that basis and have an even-up process when they get all their information. As far as independent refiners, what you may want to do is have a general rule that it is 30 days after the end of the month, however, it is 60 days in a case where they have delayed payment contracts, and that covers their delayed payment contracts as well as their cash-flow problem.

We could initiate that now, and that would not be a significant revenue effect because there is not as much there as there is with the majors, although it could be some, and "some" could be a couple of hundred million, but not the large amount.

The Chairman: If you could get us about 75 percent of it right off and the other 25 percent comes dribbling in later on, I think we would be in reasonably good shape. I just do not want to postpone getting the money that we could be getting because you have got some of these smaller fellows who have got a legitimate, real problem.

Mr. Shapiro: I think that seems to be what the Committee is suggesting.

Senator Dole: Mr. Chairman, before we agree that is what we want, I think the rest of us would like to see it. Maybe we could take a look at the proposal. Again, I think -- I am not certain -- we have independent refineries in my state and they have complained about the House bill. They do have a cash flow problem. They do not sell the product the day it arrives. The majors may be in a better position because it is an integrated operation and some small refinery in Oklahoma, Kansas or some other place, plus the fact I think that may be included in your amendment, the purchaser has to rely on the information provided by the producers.

Now, is there some provision if that information is erroneous as far as who is liable for the underpayment?

Mr. Shaprio: That is taken care of it. We have dealt with that as well.

Senator Dole: In other words, if somebody --

Mr. Shapiro: Misrepresentation on the part of the producer or the operator.

Senator Dole: Right.

So that is taken care of in your technical amendment?

Mr. Shapiro: Yes.

Senator Dole: But if we could take a look at what Senator Long suggests, because I understand now if the month of sale were in June, as is the proposal you gave us, and then the producer is required to certify oil that is purchased by the end of June, then the payment would be made in August?

Mr. Shapiro: Well, it would be at the end of July if there is no deferred payment plan. If the deferred payment plan, from the refiner to the producer, then they would not have to pay it until the end of August.

Senator Dole: The only thing I would suggest is, as far as independents, that payment date be the end of August or the 1st of September and, again, I do not know how much -- we deal only with the independent side, how much revenue are you talking about, some estimated procedure?

Mr. Shapiro: Let me give you the logic around the staff proposal that you have here.

If you did not have a windfall profits tax and if there were no deferred payment plan, the independent refiner would pay the entire $22 per barrel to the purchaser when he received it five days later, or whatever the plan was. However, many times, the independent refinery, because there is a cash flow problem, works out a deferred payment plan. He buys the oil June 1, in your example, and he does not have to pay it until the end of July to allow him to refine it and sell it to someone else so the independent refiner has the money to pay.

So we are suggesting that when you have these deferred pyament plans ---and we understand they are in the range of 30, 45 to 60 days and we are trying to take that into account, that if they did not have to pay the producer the money for the oil until a later date, then you would not have to pay the government until you gave them up to 60 days for that.

Now, it used to be that deferred payment plans were much longer, but we understand they are being renegotiated and they are getting shorter and shorter.

But 60 days seemed to take into account most of the cases that we understand. But if they do not have a deferred payment plan that just means that if they did not have windfall profits tax, they would pay the entire $22.

Senator Dole: I think the point ought to be made ---and I think everybody understands this -- it is not going to diminish the amount of tax collected.

Mr. Shapiro: That is correct.

Senator Dole: But it does have a budget impact if you have, say, 60 days, how much this fiscal year?

Mr. Shapiro: It was a significant revenue effect, under what we had suggested. It was in the neighborhood of almost $800 million. Now, under the revised proposal that the Chairman was indicating, we are talking about just a few hundred million at the most. But we will have to re-estimate that and I think what you are suggesting is you would like to see the proposal brought back.

So we will bring it back with a revised revenue estimate.

Senator Dole: As long as everybody understands the tax will be paid. It will be collected and it will be paid to the government. Our problem is budgetary, not a question of anybody not paying the tax or any preference to anybody in the oil industry.

The Chairman: We are not talking about anybody's escaping his tax liability but I would hope, though, that even with regard to the independents that we would try to get that money in so it appears in the 1980 fiscal year. In other words, where the tax -- it takes effect in January, is that not right?

Mr. Shapiro : Yes, January.

The Chairman: All right. So if it takes effect as of

January if we can start getting our money in in six months, if you allow six months lag, so that by July they are paying the money, that would be in this fiscal year.

Now, if you pass it on past October 1, if you do not get in until after October 1, then we cannot count on it in this fiscal year.

Mr. Shapiro: You know, the House bill requires semi-monthly payments. They have to start paying it in January. The real problem is your payments that are due in September. If they are pushed back to October, that gives you your budget problem in that fiscal year.

The Chairman: Well, it seems to me that if this committee is as considerate as it thinks is right and fair and gives the producers a better break than they are getting over in the House bill, we also have got a right to ask them to bring that money on in here so we can count it for this fiscal year and the fact that the Committee has tried to consider that problem and all of that, I think, puts all the more burden on us to look at the government's fiscal problem and try to get that money into us in time so we can make our plans on the overall program with some of that money -- or with as much of it as we can collect.

I do not want to do anything to brutalize somebody, but I have heard all of this talk about people having to hire additional help to comply with some of this. Well, if they hired it, fine. Let's put them to work, if that is how it is going to have to be and get this money on in, because there is no point in asking to hire the help to do the bookkeeping and pay them to do it.

So we might as well get it on in. If the tax is there it ought to be collected and it ought to be collected as currently as possible.

Mr. Shapiro: We will put that together and bring back a proposal to you on Tuesday.

The Chairman: What else do you have there?

Mr. Shapiro: We are still on page 1. We just authorize the Secretary to issue regulations which the operator of the property has to give the information to the first purchaser and where the House bill was a little more specific, we found out that it may be better to take some of the specificity away and give it to regulations because it may be an easier way to deal with once the Internal Revenue Service negotiates with the industry representatives as to what is the best way to get that information.

We show that as just a technical type change.

The next amendment would eliminate the requirement in the House bill --

The Chairman: Wait a minute. Now, that is more technical, is it not?

Mr. Shapiro: Yes. The rest of these in this category are all technical. We do not feel that any of the rest that we have on pages 1 and 2 are controversial and or have any revenue effect.

The Chairman: If there are no objections, then, we will agree to that figure.

Go ahead.

Mr. Shapiro: Last, we say we eliminate the requirement that the purchaser provide monthly information statements to producers. Instead of that, the Secretary is going to determine by regulations what information is necessary.

The Chairman: Without objection, agreed.

Mr. Shapiro: All right.

Then we have a provision which gives the statute of limitations and it says that the producer be treated as having filed his return and paid the tax on the appropriate dates even though the first purchaser acts to deposit the tax or file the returns.

That is just dealing with first purchaser types of situations, giving the producer the same effect.

The Chairman: Without objection, agreed.

Is that on page 3?

Mr. Shapiro: That is page 2 now.

The Chairman: All right.

Mr. Shapiro: Now, under the heading that says clarification, these are the types of changes that would be some clarification in the Committee report.

Senator Dole, the first one is what you were talking about about misrepresentation, to show that the operator would be liable for any misrepresentations and clearly not the first purchase, because the operator has the information and then also to grant regulatory authority to assure that certain transactions between unrelated as well as rlated parties, if there are any improprieties in that regard that the IRS has the regulatory authority to deal with any transactions which may be inappropriate.

And then there is clarified the term "operator," would actually be covered too. So these aer, essentially, clarifications that we would like to be able to put in the committee report and, once again, we do not know of any controversy on these and we have discussed them with industry people.

On page 3 is one that was suggested to us by the industry, and this is --

The Chairman: Now, we will agree that this -- what is this page 3 now?

Mr. Shapiro: Page 3 is headed "Elective Retention of Old Base Production Control Levels, BPCLs." Under the new price control regulations you can determine your lower tier base production control level by one or two methods.

First is using your historical decline curve as your 1972 to 1975 rate, or second you can use the 3 percent decline curve using your average daily production that ends in the six month period ending March 31, 1979. So there are two methods to determine your base production control level for price purposes.

Under the House bill, for tax purposes, they only had one and that is using your 1.5 percent decline rate and that is using your updated 1979.

The industry has suggested that if they should chose the historical decline curve -- the question is, for the purposes of their base production control level, if they select the historical decline curve for price purposes that they want to be able to use that same --

What we are saying is that if they choose their old BPCL -- in other words, that is what they had in '72 and '75 ---they would have that same one for tax purposes. It is letting them be consistent for price purposes and tax purposes and this is a suggestion that the industr made to us and it seemed to be appropriate that we would not impose on them, for tax purposes, a BPCL different than would be for pricing purposes.

The Chairman: Any objections?

All right. Without objection, agreed.

The Chairman: On page 4 is the on-site oil use. The House bill imposes a windfall profits tax on all production and essentially that would even cover production that is used on the property to produce more oil. The suggested amendment would say that if you used oil that is produced on a property and re-use it on the property to produce more oil, then that would be exempt from the windfall profits tax. It is not using it for any other purpose than to try to get more oil on that property.

The Chairman: Without objection, agreed.

Mr. Shapiro: On page 5 is the transfer on marginal property. The House bill has a provision to prevent avoidance of transfers of property from one situation to another whereby you would change the character of what the property would be treated as.

The amendment would extend the rule in the House bill to include qualification of oil from transferred property as marginal oil. If you do not want to transfer properties that had different characterizations so that after the transfer it would be treated differently than it would be before the transfer, and this was a drafting error that was in the Jones-Moore amendment in the House bill when it was done on the Floor.

The Chairman: Without objection, agreed.

Mr. Shapiro: Number six deals once again with the net income limitation and the way it works, as we discussed this morning with the 100 percent and 90 percent limit, but one of the administrative simplifications that may be taken into account is that when youhave gas coming from a particular property, you have a situation of allocating costs between gas and oil. In some cases, it may be very difficult to make those allocations and a suggestion was made from a simplicity standpoint is look at the net income from the entire property -- that is, your net income from your oil and your gas so that you would not recall the allocations between oil costs and gas costs.

The Chairman: Without objection, agreed.

Mr. Shapiro: On page 7 is a jurisdiction over tax cases. The Tax Court does not have jurisdiction over excise tax cases, generally, and therefore, the windfall profits tax will not be eligible to be taken to the Tax Court. It could go to the District Court.

Now, from a Tax Court basis, one of the problems that may occur in that case is that in Tax Court you do not have to pay the money. In other words, what you do is -- the IRS had deficiency and you go and argue your case.

In the District Court you have to pay the money in advance and then you ask for a refund. One of the funds that has been expressed is that we may be talking about a significant amount of money and, in some cases, there is a preference of not to pay the entire amount, but the oil industry would like the flexibility of going to the Tax Court without having to pay the money.

We suggest two ways of dealing with that situation. On the one hand, you can have a divisible amount which you can say that the windfall profits tax is divisible so that it would be predicated upon the sale of one barrel of oil so that the issue of one barrel would be brought rather than all the barrels and also to allow the Tax Court to allow jurisdiction.

Now, one of the questions that has arisen is, do you want to give the Tax Court exclusive jurisdiction or just the fact that they can have some jurisdiction on most all issues. A taxpayer has the option of either going to the Tax Court or the District Court. If they go to the Tax Court they do not have to pay the money and if they go to District Courts they have to pay the deficiency and then file for a refund.

The advantage of going to the Tax Court and giving it exclusive jurisdiction is that you would have, on a uniform basis, as to the status of the windfall profits tax, to be uniform for the entire country. As far as the oil industry it takes away some of their flexibility in that if a case has been decided in Tax Court or if they think they may have a better chance in their local district courts, they may prefer to have the flexibility to go to the court.

We have not heard much objection to this proposal as submitted. It was contemplated that you may want to consider during the Tax Court exclusive jurisdiction although it is not clear to us what problems that would present with some industry people who would like to have the flexibility of selecting a district court if they thought it would be more favorable.

The Committee could just give the Tax Court jurisdiction which they do not have today and continue to allow industry to go to district courts, or you could give it exclusive jurisdiction and know that if it is a major concern that you will hear about it and you can change your decision later, or you could deal with it in conference.

The Chairman: It would seem to me that we would be better off to leave them, to have jurisdiction in both courts, because in the end it still gets to the Supreme Court of the United Sates and, of course, you would have the potential of two separate apellate courts looking at the problem. I would think ---I do not know, but I would think that the producers might think they might be treated more fairly if they had their case in the Fifth Circuit than they would if they had it in the Court of Appeals for the District of Columbia.

Mr. Lubick: Mr. Chairman, we think it would be best if you had exclusive jurisdiction at the trial level in the Tax Court so you had uniformity of rules apply here and then you could have the appeal go to the appropriate circuit court of the taxpayers in the Fifth Circuit. He would go to the Fifth Circuit. If he was in the Fourth Circuit, he would go to the

Fourth Circuit, and you would have the appellate review the way it is today.

It seems to us it would be much easier to handle and administer this tax if the initial trials were all handled on a uniform basis in the Tax Court.

The Chairman: Well, if there is no objection then we will --

Yes, sir.

Senator Danforth: Given the fact the tax may be of short duration and further given the fact that tremendous amounts of money are going to be involved in it, it would seem to me that economic certainty is desirable. I mean, you want people to be able to make decisions to the maximum extent possible on the basis of known factors.

It would seem to me to be desirable, in so far as possible, to have one track to follow for judicial review. Can we do this in the Finance Committee?

Mr. Lubick: I think that is a very large issue you are getting into, Senator Danforth. If you want to talk about a single tax court of appeals, that is being considered currently in the Judiciary Committee, so I think if you would try to go that route you would be opening up a larger issue.

There are very good arguments for that and they apply throughout.

The Chairman: Well, if the TAx Court is going to have exclusive jurisdiction at the trial level, it seems to me that the Tax Court ought to ride circuit here. They ought to move around the country hearing these cases.

Does the tax court move around now?

Mr. Lubick: Yes, they do, and that is the situation that you have currently in Tax Court jursidiction. The Tax Court will hear the case and then the appeal will go to the circuit in which the taxpayer files his return and there are some arguments pro and con on that and it seems --

Senator Danforth: Is that the law, that the appeal is to the Court of Appeals of the Circut in which the taxpayer files his return?

Mr. Lubick: It is his residence, I believe.

Senator Danforth: His principal place of business? But it is not just where he files his return.

Mr. Lubick: I am not absolutely sure. But I thought it was where he resides or his principal place of business. I am not absolutely sure of that. I can check that out.

But the fact is that you do have appeal to all of the various circuits, the circuit to which the appeal lies being the appropriate one for -- depending on that particular taxpayer's circumstances be it residence or principal place of business and you do not have appeals going to a single court of appeals.

Senator Danforth: Have you thought out the nature of the litigation in these caes? Is it going to be factual? Is it going to be a matter of what is tertiary recovery and so on and so forth?

Or is it going to be really matters of law?

Mr. Lubick: I think probably what you said first.

Senator Danforth: Factual?

Mr. Lubick: I would think so.

Senator Danforth: And so therefore the trial court which would be really basically settling the issues --

Mr. Lubick: I think that is correct. I do not really expect a lot of appellate litigation here and therefore what there is I think could be handled by the multiplicity of circuits that we have without any serious maladministration.

Senator Danforth: My preference would be for the Tax Court for that reason, Mr. Chairman.

The Chairman: It is all right with me, but I would like to reserve judgment if I hear an explosion to come back and consider it again. We have that right anyhow.

Mr. Shapiro: Senator, that is what I would suggest. You could put it into the bill now; if there really is a problem, you could change it before the bill goes out or be in conference.

The Chairman: Without objection, we will agree to it now, but if we hear from a lot of practitioners and they are upset, then we can reconsider.

Mr. Bore

Senator Boren: Mr. Chairman, did we take up number six, the net income limitation?

Mr. Shapiro: Yes.

Senator Boren: Let me raise a question if I could go back to that. I was reading this over and I did not hear it taken up. I wonder if this is a technical amendment that is being offered here because it looks to me as if we are changing the concept.

As I read this, we are saying that the net income limitation which the House applied to oil only -- in other words, if it is costing you more to produce the barrel of oil that you get from a barrel of oil, you do not have to pay the tax.

But here they are throwing in gas income from the same property so it seems to me that they are saying, well, you could be losing 10 percent on every barrel of oil but you might have to pay the windfall profits tax if you are making up the additional revenue on gas.

That does not seem to me to be a technical amendment. It would seem to be to be a matter of policy and it would have a lot of impact --

Mr. Shapiro: Senator Boren, when I began, I clarified that, so I clarified the word "technical."

Let me point out in this one, when I mentioned this one, what I was saying was that this is a problem as to when you have oil and gas on one property, or one well, you do not always know how to allocate the costs and it could be a winner or a loser. For example, it can help you or it can hurt you. We do not know which way it would go, but it would certainly simplifies the computations.

Senator Boren: Well, I certainly think we ought to give the producer the option. If a producer feels they cannot make this allocation -- but I understand in many cases they can ---it seems to me you are changing the concept of, you know, you might throw in all sorts of other things, you might earn something on it, or something else, but I think we are changing the concept here if we get away from the barrel of oil.

The Chairman: What is this now?

Senator Boren: I am over here on page 6. The concept of the net income limitation, from my understanding was that we look at oil -- we have an oil well here -- and it is -- your tax would cause you to have a loss. And we changed that figure from 100 percent to 90 percent in the discussion this morning that you would not have to pay the tax.

But here they are saying, well, throw in your gas income as well on that property in determining whether or not -- it is by property. So you might not have dual production from all wells. You might have one well that is an oil well on the property. I think that is a question there. Why I am raising it is that I think I would object to it at this point, so we could clarify it. It would seem a policy decision if we were going to throw in other ---gas income and so on from the property and not just oil in determining the net income limitation.

The Chairman: Well, why do we not reserve that one and we can come back to it later on?

Offhand, I would think, though, that a person has a little well here and let's assume you are getting half your income from oil and half of it from gas, to see whether you are making a profit you would have to allocate your expenses half to one and half to another.

Mr. Shapiro: It works when you have half. The problems that we saw is that when you did not have half, how do you make these allocations?

We talked to some of the -- it really is just a question of simplification and administrative ease. We discussed this with a number of people in the oil industry who raised no question with us about it. We distributed this a week ago and this is the first we have heard about it.

If there is a problem we are not trying to suggest any substantive change. If there is a significant problem, we have not heard about it.

The Chairman: I would think with regard to most of your stripper wells, Senator, there is just no problem. Now, you may find -- that is what we are talking about here, are we not? We are talking about stripper wells, are we not?

Mr. Shapiro: No, this could be any property.

Senator Boren: It could be any property where your net income ---it may be all right. I just am reading this over and it seems to me it is a policy decision.

Mr. Shapiro: May I suggest this, because Senator Boren is correct. It is intended to have an admnistrative simplicity but it can cut both ways. It can help or it can hurt.

Could we have this like we did before, put it in with the understanding that we are going to talk to people and see reaction. If it does raise a concern, then we will revisit it. We just have not heard anytnng.

We talked to several people in the industry who have not raised a question. We just have not heard anything. If there is a problem --

Senator Boren: I have just heard there is objection, Mr. Chairman. In fact, it has been expressed to me by people and I do object to its being put in.

The Chairman: Well, why do we not hold it up and we are operating here kind of by unanious consent, at the moment, so why do we not hold up on this and then we will --

Senator Boren: I may agree with this policy decision, but I would like to think it through.

The Chairman: Well, the kind of people who can advise you about this are those big accounting firms like Arthur Anderson and Ernst and Ernst and people like that, are they not? Of course, these big companies have their own bookkeeping sections, but I think that you could get plenty of accounting advise on this, can you not? That is basically what you are talking about. It is mainly an accounting problem, is it not?

Mr. Shapiro: It is just that it presents some complexity. I am certainly not going to say it cannot be done and it did not seem to be a problem with the people we have talked to and apparently Senator Boren's office has heard things that have not been brought to our attention.

Senator Boren: I may well agree to it, but I would like to object for now.

The Chairman: Well, we will hold it up.

Mr. Shapiro: We will work it out and we will talk to you.

The other thing on the Tax Court, the Tax Court has requested from the Committee, completely apart from the jurisdiction in windfall profits tax cases, three additional judges because of their increasing workload over the last several years. They now have sixteen judges and they think they need additional ones.

We thought it may be approoriate that in view of the fact that we are giving them additional jurisdiction here that thi may be the appropriate time to give them the three additional judges --

The Chairman: Maybe we ought to establish a separate tax court just for the windfall profits tax. I think there would be enough business to keep them busy.

Do you think, Mr. Lubick, that we can find enough business to keep them really just on this?

Mr. Lubick: I do not think there is going to be a lot of litigation under this, Mr. Chairman.

Senator Dole: They will not be able to afford it.

The Chairman: Well, you are asking for three more judges here and if it is that much business, I just wonder -- how many judges do we have up there already up there on the Tax Court?

Mr. Shapiro: It is 16 now. It is the Tax Court that is actually requesting the three additional judges, and I will tell you, the request predated the windfall profits tax.

The Chairman: The Tax Court is asking for three more judges.

Mr. Shapiro: The Tax Court itself is asking for three additional judges and they are doing so on the basis of their present workload.

The Chairman: Well, let me ask you about this. When the

TAx Court makes a decision, if you have 16 judges up there, do all 16 of them have to study this and take a position on it?

Mr. Lubick:* There are different types of opinions. In most opinions, they are handled by a single judge of the Tax Court and it just goes out as a memorandum decision. That is the overwhelming majority. Then if the Chief Judge of the Court thinks the matter ought to be reviewed by the entire court, then they have a meeting on it ---where it is a very important one. But that is a relatively small proportion of it.

Their backlog has been increasing. We have sought to reduce that by simplifying the law, but apparently we have not been too successful in that.

So given the state of matters, their backlog has built up and it is harder to get a decision within a relatively short period of time.

The Chairman: What I am concerned about is where you get the significant issues before the Court it might take a lot of time and tie up an awful lot of judges sitting there, and it seems to me if you are going to give them three more judges, you had better divide them up into two courts so at least you would not have more than nine or ten people chewing on a problem at a time.

Mr. Lubick: I do not think that is the problem, Mr. Chairman. I think it is just the volume and in addition, in the last few years we have added to their load by giving them, in effect, declaratory judgment jurisdiction over charities and over tax-exempt bonds and over pension funds and there has just been the general increase in litigation that has come along. In spite of the fact that they have had masters to try a lot of issues of fact in small court jurisdiction, there has been an increasing volume of tax litigation.

The Chairman: All right, then. Without objection, we will recommend three more judges.

Senator Dole: Is that in the House bill, too?

Mr. Shapiro: No. Under the House bill, the Tax Court does not have jurisdiction over the windfall profits taxes and somewhere along the way, the Tax Court has sent up a series of recommendations and this just seemed to be an appropriate time to consider it, since you are givng them additional jurisdiction.

The Chairman: All right.

What next?

Mr. Shapiro: The last one that we have is on page 8 and this is an amendment on production payments. Under the House bill there is one case which imposes the tax on a person other than the holder of an economic interest and that is where you have a production payment which involves a payment to someone until a cumulative payment amounts to a fixed number of dollars.

Now, the provision in the House bill appears now to be unnecessary since, as we understand it, the production payment contracts generally provide for an adjustment to take into account certain additional taxes such as windfall profits taxes and we would suggest that you eliminate that special rule in the House bill that deals with the production tax.

The Chairman: Without objection, agreed.

I guess that is about all we can do now, and in view of the fact that we cannot settle this thing for the poor today because we do not, so far as I know, we have not been able to focus on one proposal that the majority of the Committee might want to recommend, so I guess we will have to go over until Tuesday, then.

Monday is Columbus Day and we will have difficulty getting a quorum on that day.

Senator Dole?

Senator Dole: I might suggest that we have instructed our staff to work with Senator Moynihan and others, Senator Bradley, to see if we can reach some consensus on low-income assistance. Maybe we can find a majority.

The Chairman: Well, I wish that the members of the Finance Committee staff and the Joint Committee staff can help them, the minority as well as with the regular staff members and give us the best thoughts they could have.

Senator Dole: Then, on Tuesday, we will bring up Alaska and upper tier and --

Mr. Shaipiro: Then you go to the Floor, and we will have the credits that will be available.

The Chairman: Okay.

Thank you very much.

(Whereupon, at 12:05 p.m. the Committee recessed, to reconvene on Tuesday, October 9, 1979.)

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