CRUDE OIL "WINDFALL PROFIT" TAX ACT OF 1980

*John S. Logan**

I. Introduction

This article provides an overview of the so-called "windfall profit" tax on crude oil and focuses primarily on the administrative problems and compliance planning opportunities which have come to light in the few months that the tax has been in effect.

President Carter signed the Crude Oil Windfall Profit Tax Act of 1980[1] on April 3, 1980. The new "windfall profit" tax applies to first sales of domestic crude oil removed after February 29, 1980. As a result, producers have suffered an immediate reduction in crude oil receipts because first purchasers, who in many cases are refiners, have been required to withhold the tax from the purchase price. The statute does not provide an exemption for independent producers. Rather, independent producers are subject to a lower tax rate for certain categories of oil termed "independent producer crude oil."

The "windfall profits" tax—which is not based on profits, but is an excise tax on a portion of domestic crude oil revenues[2]—is tied to the removal of existing price controls on domestic crude oil. The tax will obtain for the federal government a substantial portion of the additional crude oil revenues resulting from the lifting of price controls and the rising world market price for crude oil. In general, the tax is levied on the mislabeled "windfall profit" —the difference between the first sale price of a barrel of oil and a statutorily-defined adjusted base price considerably below prevailing market levels, with an additional adjustment for certain state severance taxes on the "windfall profit" element. The tax rate applied to crude oil subject to the "windfall profit" tax varies depending upon its "tier," a statutorily-defined classification generally based on Department of Energy ("DOE") price-control categories.

This article discusses the regulations issued by the Internal Revenue Service ("IRS") through November 14, 1980. On April 4, 1980, immediately after the President signed the "windfall profit" tax into law, the IRS published its first set of temporary regulations implementing the windfall profit tax.[3] The preamble to the temporary regulations stated that the rules were generally effective for all domestic crude oil removed after February 29, 1980.[4] Concurrently with the issuance of the temporary regulations, the IRS published a notice of proposed rulemaking in which it proposed to issue the temporary regulations as final rules.[5] Subsequently, the IRS has issued five additional sets of temporary regulations to implement the tax and, in each instance, has issued a notice of rulemaking in which it proposed to issue the

*B.A. Vanderbilt University; J.D. University of Virginia; Member, District of Columbia Bar; Associate, Kirkland & Ellis, Washington, D.C. This article is dated November 14, 1980.

[1]Pub. L. No. 96-223, 94 Stat. 229, *codified in* I.R.C. § 4986 *et seq.*

[2]*See* I.R.C. § 4998(a).

[3]Temporary Excise Tax Regulations Under the Crude Oil Windfall Profit Tax Act of 1980, 26 C.F.R. § 150.0 *et seq.*, 45 Fed. Reg. 23383 (April 4, 1980).

[4]*Id.*, 45 Fed. Reg. at 23384.

[5]45 Fed. Reg. 23400 (April 4, 1980).

temporary regulations as final rules.[6] As of November 14, 1980, no final "windfall profit" tax regulations had been issued.

II. Relationship of the Tax to DOE Crude Oil Price Controls

The Crude Oil Windfall Profit Tax Act borrows heavily from the existing DOE regulatory framework for crude oil price controls and, in several instances, specifically incorporates by reference DOE regulations as of particular dates. In many respects, the "windfall profit" tax is a continuation of price control regulations, with a percentage of the removal price above the base price going to the Government rather than to consumers of petroleum products. Thus, the background of crude oil price controls is important to an explanation of the tax.

To implement price controls on domestic crude oil, the Nixon administration in 1973 adopted a two-tier price rule for domestic production. The regulations required a producer to assign each crude oil "property" a base production control level derived from production in a 1972 base period. Production in excess of the base period production control level ("upper tier" oil) could be sold at a higher price than production below the base period level ("lower tier" oil). While the basic two-tier framework remains in effect, DOE and its predecessor agencies have made significant changes in the price control scheme. Modifications to the price control program have included the establishment of additional categories of crude oil, changes in the ceiling prices, and revisions in the method of computing the base production control level, referred to as the "BPCL."

On April 5, 1979, President Carter announced his intention to begin the phased decontrol of domestic crude oil prices so that by September 30, 1981, all crude oil would be free of price controls. As part of the phased decontrol program, the DOE established several additional categories of crude oil and provided producers options to revise BPCLs on existing properties. Viewed as a whole, the effect of the DOE's phased decontrol regulations is to release lower tier oil to upper tier and to release all upper tier crude oil to market prices at a gradual rate.[7]

Under the "windfall profits" tax, base prices and tax rates generally are keyed to classifications of crude oil existing under price controls. Thus, DOE price control distinctions largely determine the tax treatment of crude oil under the "windfall profits" tax. Except for the category of "heavy oil," each of these classifications refers to circumstances surrounding the production and

---

[6]*See* 45 Fed. Reg. 27903 (April 25, 1980) (withholding and depositing for an integrated producer), *proposed as final regulations*, 45 Fed. Reg. 27953 (April 25, 1980); 45 Fed. Reg. 63263 (September 24, 1980) ("highest posted price" for base price computations), *proposed as final regulations*, 45 Fed. Reg. 62397 (April 25, 1980); 45 Fed. Reg. 64574 (September 30, 1980) (base price determinations for Tier 2 and Tier 3 oil after September 30, 1980), *proposed as final regulations*, 45 Fed. Reg. 64603 (September 30, 1980); 45 Fed. Reg. 73467 (November 5, 1980), (tax deposits and refunds based on the net income limitation) *proposed as final regulations*, 45 Fed. Reg. 73512 (November 5, 1980); 45 Fed. Reg. 75206 (November 14, 1980) (revised base price computations for Tier 2 and Tier 3 oil after September 30, 1980), *proposed as final regulations*, 45 Fed. Reg. 75231 (November 14, 1980).

Since the IRS has treated its temporary regulations as proposed regulations, subsequent references to the proposed regulations ("Prop. Reg.") are also references to the existing temporary regulations, unless otherwise indicated.

[7]*See generally* J. Carroll, "Department of Energy Crude Oil Producer Price Regulations: An Overview and an Update," 12 *Nat. Res. Law.* 327 (1979).

sale of the oil, and not to the characteristics of the oil itself. The following are the most significant DOE price control categories of crude oil for purposes of the tax:

(1) *Lower tier oil:* Lower tier oil is production below the BPCL of a property. Under price controls, the nationwide average wellhead price for lower tier crude oil in July 1980 was approximately $6.55 per barrel.[8] Under phased decontrol, lower tier crude oil gradually will be released to upper tier.[9]

(2) *Upper tier crude oil:* Upper tier oil is production in excess of the BPCL of a property. Under price controls, the nationwide average wellhead price for upper tier crude oil in July 1980 was approximately $14.57 per barrel.[10] Beginning in January 1980, 4.6 percent of upper tier oil produced from a property in a month could be sold at market prices. The amount of upper tier oil released to market prices has been increasing by 4.6 percent each month, so that all upper tier oil (including lower tier oil released to upper tier) will be released to market prices after September 1981.[11]

(3) *Stripper well oil:* Stripper well crude oil is crude oil produced from a property with a per-well average daily production of less than 10 barrels per day at maximum feasible rates of production for a 12-month qualifying period. A producer may sell stripper production at market prices.[12]

(4) *Marginal Crude Oil:* Marginal crude oil is oil which otherwise would be lower tier crude oil and which is produced from properties with a specified high average depth of completion and a specified low average daily per-well production at maximum rates. The marginal crude oil category was established as one mechanism to release lower tier crude oil to upper tier prices.[13]

(5) *Newly Discovered Crude Oil:* Newly discovered crude oil is oil produced from an onshore property which did not produce in 1978, or from a new offshore lease entered into after 1978. Newly discovered crude oil may be sold at market prices.[14]

(6) *Incremental Tertiary Crude Oil:* Incremental tertiary crude oil is oil which is produced from a qualified enhanced tertiary recovery project and which is in excess of a property's decline curve, as defined by DOE regulations. Incremental tertiary oil may be sold at market prices.[15]

(7) *Tertiary Incentive Crude Oil:* Tertiary incentive crude oil is oil which is released from price controls for the purpose of providing upfront financing for certain qualifying tertiary recovery projects. Crude oil qualifies

---

[8]Source: Office of the Economic Regulatory Administration, Domestic Crude Oil First Purchaser Program.

[9]*See, e.g.*, 10 C.F.R. §§ 212.72 ("base production control level"), 212.73, 212.76.

[10]Source: Office of the Economic Regulatory Administration, Domestic Crude Oil First Purchaser Program.

[11]*See* 10 C.F.R. §§ 212.72 ("market level new crude oil"), 212.74; *see also* 44 Fed. Reg. 66186 (November 19, 1979)).

[12]10 C.F.R. § 212.54.

[13]10 C.F.R. §§ 212.72 ("marginal property"), 212.72 ("base production control level"); *see also* Production Incentives for Marginal Properties, 44 Fed. Reg. 22010 (April 12, 1979).

[14]*See* 10 C.F.R. §§ 212.75, 212.79; Incentive Prices for Newly Discovered Crude Oil, 44 Fed. Reg. 25827 (May 2, 1979); *see also* Notice of Proposed Rulemaking, Newly Discovered Crude Oil Rule Amendments and Verification Requirements, 45 Fed. Reg. 42222 (June 23, 1980).

[15]*See* 10 C.F.R. § 212.78; *see also* General Guidelines on Tertiary Incremental and Incentive Programs, 44 Fed. Reg. 51148 (August 30, 1979), 45 Fed. Reg. 47622 (July 15, 1980).

for tertiary incentive prices because the funds from the sale will be used to assist in financing a qualified tertiary project. Thus, oil may qualify for tertiary incentive prices regardless whether it was produced from a tertiary recovery project.[16]

(8) *Heavy Crude Oil:* Under price control regulations, heavy crude oil is oil with a weighted average API gravity of 20° or less, corrected to 60°F. Heavy crude oil may be sold at market prices.[17]

In borrowing from the existing DOE regulatory framework for crude oil pricing, the "windfall profit" tax both incorporates some of the existing ambiguity in the DOE regulations and adds some additional questions. The statute specifically incorporates DOE regulations as of stated dates to define various terms in the statute, particularly tax categories of oil.

The statute does not fully resolve the relationship between the tax and existing DOE regulations. The Secretary of the Treasury has the power to promulgate rules and regulations to carry out the purposes of the statute, "including such changes in the application of the [DOE] energy regulations as may be necessary or appropriate to carry out such purposes."[18] However, questions are likely to arise concerning the extent to which the Secretary may make substantive alterations, since Congress has expressly adopted particular DOE regulations as part of the statute. Moreover, it is also likely that questions will arise concerning the extent to which the Secretary is bound to follow DOE interpretations of the incorporated regulations.

A related issue arises from subsequent decisions by DOE or the courts regarding the incorporated energy regulations. Basic concepts of the two-tier price regulation scheme, such as the definition of "stripper well" properties and the DOE "property" definition itself, are now in litigation before the agency and the courts.[19] Court decisions which invalidate DOE regulations or interpretations may well have a direct effect upon basic regulatory concepts which Congress chose to embody in the "windfall profit" tax.

Additionally, since the passage of the "windfall profit" tax, DOE, through interpretations, rulings, and decisions by its Office of Hearings and Appeals, has detailed some of the crude oil regulatory concepts. DOE has also instituted a rulemaking proceeding which, among other things, proposes to clarify the definition of "newly discovered crude oil" to comport with the agency's original intent. Each of these actions may have retroactive effect; that is, DOE intends its pronouncements to reflect the original meaning of its regulations. It remains to be seen whether the Internal Revenue Service will defer to DOE's subsequent pronouncements of the meaning of its regulations or whether it will attempt to make independent interpretations of DOE regulations insofar as they apply to the "windfall profit" tax. A divergence

---

[16]*See id.*

[17]*See* Exec. Order 12153 (August 17, 1979), 44 Fed. Reg. 48949 (August 21, 1979) *amended by* Exec. Order 12186 (December 21, 1979), 44 Fed. Reg. 76477 (December 26, 1979), and Exec. Order 12189 (January 16, 1980), 45 Fed. Reg. 3559 (January 18, 1980).

[18]I.R.C. § 4997(b).

[19]*See, e.g.*, United States v. Exxon Corp., Civ. Action No. 78-1035 (D.D.C.); Pennzoil Co. v. Dept. of Energy, Civ. Action No. 78-335 (D. Del.); Cotton Petroleum Corp. v. Duncan, No. 79-C-271-B (N.D. Okla.).

between the DOE and the IRS over the interpretation of the energy regulations could impose a substantial burden on producers and first purchasers by requiring additional accounting and reporting systems to comply with the "windfall profit" tax and with price control regulations.

III. STRUCTURE OF THE TAX

A. *Taxable Persons and Exempt Crude Oil*

The taxable entity under the Act is the "producer"—defined as the person who holds the economic interest in the oil.[20] This definition includes working interest owners, royalty owners, and holders of production payments. Where crude oil is owned by a partnership, the partnership's economic interest in the oil is allocated among the partners on the basis of each partner's proportionate share of the partnership's income.[21] The Act and the regulations treat the partner to whom the oil is allocated, not the partnership, as the "producer." Thus, the tax is imposed directly on the partners' proportionate share of the partnership's production.

Under the "qualified governmental interest" exemption, oil produced from interests owned by states and subdivisions of states is exempt from the tax to the extent that proceeds from these interests are dedicated to a public use.[22] Oil attributable to certain Indian-owned interests,[23] or to interests held by qualified charitable, educational, and medical facilities is also exempt from the tax to the extent that production is attributable to an interest held on January 21, 1980. Oil produced from an interest held by a church on January 21, 1980, is exempt, if the church continues to use the proceeds from the sale of such oil to support medical or educational facilities.[24] Also exempt from the tax are Alaskan oil produced from specified areas[25] and "exempt front-end" oil, which is oil exempted from the tax so that additional revenues can be used to finance certain qualifying tertiary recovery projects.[26]

B. *Computation of the Tax*

The "windfall profit" tax will capture a portion of the additional revenues resulting from decontrol which otherwise would accrue to producers. For each barrel of crude oil, the tax equals the tax rate times the taxable "windfall profit," which is defined as the selling price of the crude oil minus an adjusted base price and minus a state severance tax adjustment,[27] as shown by the following:

Tax = Rate × "Windfall Profit"

"Windfall Profit" = (sales price) - (adjusted base price) - (state severance tax adjustment)[28]

[20] I.R.C. §§ 4986, 4996(a); Prop. Reg. § 150.4996-1(b).

[21] *Id.*

[22] I.R.C. § 4994(a).

[23] I.R.C. § 4994(d).

[24] I.R.C. § 4994(b).

[25] I.R.C. § 4994(e).

[26] I.R.C. § 4994(c). For a discussion of this exemption, see C. Reese, "Temporary Windfall Tax Regulations: Much Ado About Nothing?" 29 *Oil & Gas Tax Q.* 1, 20-22 (1980).

[27] The state severance tax adjustment is discussed *infra*, Part III G.

[28] *See* I.R.C. §§ 4987, 4988(a).

C. *Tax Classifications of Crude Oil*

The "windfall profit" tax establishes three categories of crude oil, Tier 1, Tier 2, and Tier 3, based largely upon classifications established during DOE price controls. Tier 1 includes all non-exempt crude oil which is neither Tier 2 nor Tier 3 oil, and thus includes crude oil which would have been classified as upper tier, lower tier, or marginal crude oil under DOE price controls.[29] Tier 2 crude oil includes crude oil which would qualify as stripper well crude oil under DOE regulations and any crude oil from an interest in the U.S. National Petroleum Reserve.[30] Tier 3 oil includes incremental tertiary crude oil,[31] heavy oil,[32] and newly discovered crude oil.[33]

Under DOE regulations, the price-control category of crude oil generally depends upon the "property" from which the oil is produced. Since the "windfall profit" tax relies substantially on DOE price control categories to define the tier of oil subject to the tax—and thus the tax rate and base price —the DOE "property" concept is an important part of the "windfall profit" tax scheme. The DOE "property" definition differs substantially from the definition "property" in Section 614 of the Internal Revenue Code used for calculating the depletion allowance.

Significantly the DOE "property" concept has had a checkered history and even now is the subject of litigation challenging the validity of the rule and subsequent modifications of it by DOE and its predecessor agencies.[34] Subsequent judicial invalidation of the DOE rule or agency interpretations of it may well affect the determination of the tier of oil for purposes of the "windfall profit" tax, since the price-control categories incor-

[29] *See* I.R.C. § 4991(c).

[30] I.R.C. § 4991(d).

[31] I.R.C. § 4991(e)(1)(C). "Incremental tertiary oil" is separately defined in I.R.C. § 4993, which in part incorporates by reference the June 1979 DOE regulations. For a discussion of the definition and tax treatment of "incremental tertiary oil," see C. Reese, *supra* note 26, at 23-25.

[32] I.R.C. § 4991(e)(1)(B). Under existing price controls, any crude oil with a weighted average API gravity of 20° or less is defined as heavy oil and may be sold at market prices. *See* note 17, *supra*, and accompanying text. The tax bill's definition only includes oil of 16° or less weighted average API gravity. I.R.C. § 4991(e)(3) defines "heavy oil" as

> all crude oil which is produced from a property if crude oil produced and sold from such property during—
>
> (A) the last month before July 1979 in which crude oil was produced and sold from such property, or
>
> (B) the taxable period,
>
> had a weighted average gravity of 16 degrees API or less (corrected to 60 degrees Fahrenheit).

See also Prop. Reg. § 150.4991-1(b).

[33] I.R.C. § 4991(e)(1)(A). The statute adopts the definition of newly discovered crude oil in the June 1979 DOE regulations. I.R.C. § 4991(e)(2). The Conference Report on the "windfall profit" tax states that a property will not be disqualified from the newly discovered category because of production from exploratory drilling, so long as no crude oil was produced in commercial quantities during 1978. *See* Conference Report, Crude Oil Windfall Profit Tax Act of 1980, H.R. Rep. No. 96-818, 96th Cong., 2d Sess. (March 7, 1980), at 97-98 (hereinafter cited as *"Conference Report")*. The temporary regulations adopt by reference the definition in the June 1979 DOE regulations, but do not refer to the additional qualifications which appear in the *Conference Report*.

[34] *See, e.g.*, cases cited in note 19, *supra*.

porated by reference from DOE regulations are, for the most part, directly dependent on the DOE "property" definition.[35]

D. *Base Prices for Crude Oil*

The base price for each tier of crude oil produced from a property is subject to quarterly adjustment for inflation to obtain the adjusted base price. The mechanism for adjustment, which uses the GNP price deflator, will result in a two-quarter lag in the inflation adjustment.[36] The base price for Tier 3 oil receives an additional quarterly incentive adjustment amounting to 2 percent each year.[37]

1. Tier 1 Crude Oil

Under the temporary regulations, the base price for Tier 1 oil is set by adjusting the upper tier price for oil sold in May 1979. But, unlike DOE price controls, the temporary regulations apparently do not permit subsequent adjustments to the base price for changes in the grade and quality of oil. Thus, it appears that changes in the API gravity after the reference month for computing the base price would not be taken into account, unless the gravity change should cause the property to produce "heavy oil," thus shifting it to Tier 3.

The base price for Tier 1 oil is the ceiling price under the March 1979 DOE regulations for crude oil produced and sold in May 1979, reduced by 21 cents.[38] To determine the base price, the producer must use the grade and quality of the oil produced from the property in May 1979, or, where production varied during the month, must use the per barrel average grade and quality for May 1979.[39] If no oil was produced in May 1979, the base price will be determined by reference to the grade and quality produced in the first month of commercial production after May 1979.[40]

---

[35]The "windfall profit" tax defines stripper well oil and newly discovered oil by reference to the June 1979 DOE regulations. I.R.C. §§ 4991(d)(1)(A), 4991(e)(2), 4996(b)(8). The June 1979 DOE regulations contain the current DOE property definition:

> "Property" means the right to produce domestic crude oil, which arises from a lease or from a fee interest. A producer may treat as a separate property each separate and distinct producing reservoir subject to the same right to produce crude oil, provided that such reservoir is recognized by the appropriate governmental regulatory authority as a producing formation that is separate and distinct from, and not in communication with, any other producing formation.

10 C.F.R. § 212.72. The DOE's predecessor agency, the Federal Energy Administration, addressed the concept of "property" in Ruling 1975-15, 40 Fed. Reg. 40832 (September 4, 1975); Ruling 1977-1, 42 Fed. Reg. 3628 (January 19, 1977); and Ruling 1977-2, 42 Fed. Reg. 4409 (January 26, 1977). *See also Clarifications to Mandatory Petroleum Price Regulations Applicable to Domestic Crude Oil*, 41 Fed. Reg. 36172 (August 26, 1976). The temporary regulations define "property" (except with regard to the net income limitation) as having the same meaning as in 10 C.F.R. § 212.72 of the DOE regulations and FEA Ruling 1977-1. Prop. Reg. § 150.4996-1(i). Additionally, the IRS has amended its base price regulations for Tier 2 and Tier 3 oil removed after September 30, 1980, to provide for determination of the adjusted base price on a property-by-property basis. 45 Fed. Reg. at 75207. For purposes of these base price determinations, the definition of "property" in Prop. Reg. § 150.4996-1(i) is modified so that, in the case of multiple reservoirs subject to a single right to produce *(e.g.,* a lease containing several reservoirs not recognized as separate properties), a reservoir from which no oil was removed pursuant to the right before November 14, 1980, will be treated as a separate property. Thus, the status and interpretation of the DOE property definition has substantial implications for the "windfall profit" tax scheme.

[36]*See* I.R.C. § 4989(a) & (b); *Conference Report* at 103-104.

[37]*See* I.R.C. § 4989(b)(2); *Conference Report* at 97.

[38]I.R.C. § 4989(c); Prop. Reg. § 150.4989-1(b).

[39]Prop. Reg. § 150.4989-1(b) states that for purposes of determining the Tier 1 base price, "the grade and quality of the oil produced from the property in May 1979 shall be used."

[40]Prop. Reg. § 150.4989-1(d).

2. Tier 2 and Tier 3 Crude Oil

For Tier 2 and Tier 3 oil, the IRS has issued an interim rule applicable to oil removed prior to October 1, 1980,[41] and a temporary rule—published on September 30, 1980, and proposed as a final regulation—which applies to crude oil removed on or after October 1, 1980.[42] On November 14, 1980, the IRS amended the September 30 temporary regulations and proposed the amended rule as a final regulation. The November 14 rule applies to all crude oil removed after September 30, 1980.[43] To ease implementation of the new rule, the November 14 regulations provide that—until December 14, 1980—producers and purchasers, at their option, may deposit and withhold revenues under the interim rule, the September 30 rule, or the November 14 rule. Thereafter, the November 14 regulations are mandatory and subsequent adjustments would have to be made to conform amounts withheld and deposited after September 30, 1980, to the November 14 regulations.[44]

a. *Interim Rule Applicable to Crude Oil Removed Prior to October 1, 1980*

Under the interim rule, computation of the base price for Tier 2 and Tier 3 oil removed prior to October 1, 1980, begins with determining the highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field.[45] On September 19, 1980, the IRS issued amended interim temporary regulations[46] which make the concept of "highest posted price" essentially the same as that employed by DOE price controls. The new regulations define with greater particularity the "posted price" from which the base price is derived for oil of a given tier from a particular property; they also purport to apply retroactively to all production after February 29, 1980. The IRS expressly noted in the preamble to the amended regulations that some producers may be subject to withholding adjustments where the postings used to obtain reference prices are not valid under the September 19 regulations.

The September 19 regulations define "posted price" to mean

> a written statement of crude oil prices constituting an offer to purchase oil at that price circulated publicly among sellers and buyers of crude oil in a particular field in accordance with historic practices.[47]

According to the regulations, formality of a printed price bulletin is not required for a valid posted price, but the price must have been publicly circulated in written form; oral offers and offers made only to specific producers are unacceptable. The offer must have applied generally to all oil in the field.

[41]Prop. Reg. § 150.4989-1(c), 45 Fed. Reg. 23383 (April 4, 1980), *amended in* 45 Fed. Reg. 63263 (September 24, 1980) *amended in* 45 Fed. Reg. 64574 (September 30, 1980).

[42]Prop. Reg. § 150.4989-1(c), 45 Fed. Reg. 64574 (September 30, 1980).

[43]45 Fed. Reg. 75206 (November 14, 1980).

[44]Prop. Reg. § 150.4989-1(c)(7); *see also* 45 Fed. Reg. at 75208.

[45]Prop. Reg. § 150.4989-1(c)(8)(i)(A).

[46]45 Fed. Reg. 63263 (September 24, 1980.

[47]Prop. Reg. § 150.4989-1(c)(8)(i)(B).

The regulations state that:

> [a] written contract, of course, would not qualify as a posted price because it represents an agreement between a buyer and a specific producer, not a bona fide offer to purchase from *all* producers.[48]

An offer does not qualify as a "posted price" for December 31, 1979, unless it was initially made on or before that date and was in effect for oil purchased on that date. If the posting was circulated and in effect on December 31, 1979, a producer may treat a subsequent adjustment of that posting as a valid posted price if (1) the posted price, as adjusted, was circulated on or before January 14, 1980, and (2) the posted price, as adjusted, applied to all crude oil purchased pursuant to the original offer.[49]

For purposes of determining the highest posted price for "a particular field," the term "field" means "a general area underlain by one or more reservoirs."[50] Historic field designations used by the industry and regulatory agencies generally will be treated as the "field." The IRS stated that it will presume that price bulletins specifying a geographical area and a grade of crude oil will apply to every field in the area, unless a field is specifically excluded. A bulletin specifying a higher price for oil from specifically named fields in an area supercedes the area wide posting for the named fields only. According to the IRS regulations, "posted prices" do not include offers to buy at unstated sums, such as "a price determined to be competitive," or offers to buy at a premium above posted prices that may have been paid on December 31, 1979.[51]

The September 19 regulations define "posted price" with greater specificity than the April 4 regulations and omit the requirement that a valid posted price must have been published "by a purchaser of a substantial volume of crude oil in the field." The September 19 regulations closely conform to DOE's present interpretation of "posted price" for price control purposes.

If the grade and quality produced from a property varied during the month of December 1979, the producer must use the per barrel average grade and quality in determining the highest posted price.[52]

Under the interim rule in the September 19 regulations, the base price for Tier 2 and Tier 3 oil can be expressed as follows:[53]

P = highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field (or, if there is no posted price for that field, the nearest comparable field for which a posting exists)

Tier 2:

$$P \times \frac{15.20}{35} = \text{base price (in dollars)}$$

---

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] Prop. Reg. § 150.4989-1(d).

[53] Prop. Reg. § 150.4989-1(c)(8). The adjusted base price would then be determined by multiplying the base price by the appropriate quarterly inflation adjustment. *See* Prop. Reg. § 150.4989-1(a).

Tier 3:

$$P \times \frac{16.55}{35} = \text{base price (in dollars)}$$

The statute and the regulations specify a minimum base price for Tier 2 and Tier 3 oil. Congress included this provision to avoid inequitable tax treatment for certain areas (primarily California) where prices were relatively depressed in December 1979.[54] Under the interim rule, the base price will not be less than the ceiling price which would have applied under the March 1979 DOE regulations for oil produced and sold in May 1979, plus one dollar for Tier 2 oil and two dollars for Tier 3 oil. This determination is based on the grade and quality produced from the property in May 1979.[55] If no crude oil was produced from the property in May 1979, the producer must use the grade and quality produced in the first month of production after May 1979. If grade and quality varied during the reference month, the regulations indicate that the producer should use the average grade and quality.[56]

b. *Proposed Permanent Regulations for Tier 2 and Tier 3 Adjusted Base Prices and Temporary Rules Applicable to Crude Oil Removed After September 30, 1980.*

For Tier 2 and Tier 3 oil, the statute directs the Secretary of the Treasury to prescribe a method for determining base prices which will reflect grade, quality, and field differentials based upon a hypothetical December 1979 nationwide average sale price (excluding Alaskan Sadlerochit crude oil) of $15.20 per barrel for Tier 2 oil and $16.55 per barrel for Tier 3.[57]

The IRS has recently issued temporary regulations on base prices for Tier 2 and Tier 3 oil to comply with the statutory mandate.[58] The September 30 regulations fix the per barrel actual average removal price for uncontrolled domestic crude oil during December 1979 at $35.80. These temporary regulations are also proposed as final base price regulations for Tier 2 and Tier 3.[59] The proposed final regulations differ from the interim base price rules by relying upon actual removal prices during the base period rather than on the highest posted price concept derived from DOE price regulations. The November 14 amendments altered the September 30 regulations by providing that the base price will be determined on a property-by-property basis, rather than reservoir-by-reservoir.[60] The November 14 amendments also modified the term "property" solely for purposes of determining Tier 2 and 3 base prices. Where multiple reservoirs are subject to a single right to produce, a reservoir from which no oil was removed under that right before November 14, 1980, will be treated as a separate property.[61]

---

[54] *See Conference Report* at 96-97.
[55] Prop. Reg. § 150.4989-1(c)(8)(ii).
[56] Prop. Reg. § 150.4989-1(d).
[57] I.R.C. § 4989(d); *see also Conference Report* at 95-96.
[58] 45 Fed. Reg. 64574 (September 30, 1980).
[59] 45 Fed. Reg. 64603 (September 30, 1980).
[60] 45 Fed. Reg. at 75207. This change was termed a "clarification."
[61] Prop. Reg. § 150.4989-1(c)(1).

Under the November 14 amendments, the adjusted base price of Tier 2 and Tier 3 crude oil from a particular property is determined by multiplying the defined "uncontrolled base period price" by the appropriate "tier multiplier" and then adjusting the resulting product by the appropriate inflation factor. The Tier 2 multiplier is 0.42458; the Tier 3 multiplier is 0.46229.[62] The IRS publishes the Tier 2 and Tier 3 inflation factors quarterly. The Tier 3 inflation factor includes an additional incentive adjustment.[63]

The method for determining the "uncontrolled base period price per barrel" for Tier 2 and Tier 3 oil from a property varies depending upon whether oil produced from the property was sold in uncontrolled sales during the base period. If the property in question produced crude oil which was sold in uncontrolled sales during December 1979, the "uncontrolled base period price" is the weighted average removal price per barrel of crude oil from the property sold in those sales.[64] The regulations state that price adjustments cannot be taken into account absent "clear and convincing evidence that the adjustments were fixed before March 1, 1980."[65] If this determination cannot be made with reasonable certainty, the producer must use the calculation for properties with no uncontrolled base period sales.[66]

For properties with no uncontrolled sales in December 1979, the "uncontrolled base period price" is the price that would have been obtained if the oil had been sold in uncontrolled sales during that period.[67] Thus, if oil produced from the same reservoir was sold in uncontrolled sales during December 1979, the "uncontrolled base period price" is the representative price for that oil. Otherwise, the "uncontrolled base period price" is the representative price of oil produced and sold in uncontrolled December 1979 sales from the nearest reservoir producing oil of similar grade and quality.[68]

---

[62]Prop. Reg. § 150.4989-1(c)(5). The multipliers are, respectively, the ratios of $15.20 (Tier 2) and $16.55 (Tier 3) to $35.80, the figure determined by the IRS to represent the actual average removal price of all uncontrolled domestic crude oil (except Alaskan Sadlerochit oil) sold during December 1979. *See* 45 Fed. Reg. at 64575.

[63]Prop. Reg. § 150.4989-1(a); *see also* I.R.C. § 4989(b)(2). A special adjustment is applied to the base price of Alaskan crude oil from the Sadlerochit reservoir. *See* I.R.C. § 4996(d).

[64]Prop. Reg. § 150.4989-1(c)(2). The weighted average is determined by multiplying the number of barrels sold at each price by the price at which the barrels were sold, adding the products, the dividing by the total number of barrels sold in such sales. *Id.*

[65]Prop. Reg. § 150.4989-1(c)(2).

[66]*Id.* The temporary regulations provide that for purposes of operator certifications of the adjusted base price of Tier 2 and 3 oil pursuant to Prop. Reg. § 150.6050C-1(b)(3), the removal prices will be treated as "ascertained with reasonable certainty" if:

> (i) the operator has books and records maintained by the operator (or by a former operator) which the current operator believes to be correct and which contain sufficient information to enable the operator to accurately compute such price for the property; or
>
> (ii) the operator receives a written statement or statements under the penalties of perjury (from a person or persons who were purchasers or producers of oil removed from the property during December 1979 or the operator or holder of the division order with respect to the property during such month) from which the uncontrolled base period price for the property can be accurately computed.

Prop. Reg. § 150.4989-1(c)(2). Additionally, under Prop. Reg. § 150.4989-1(c)(2)(ii), every producer, purchaser, operator, or holder of a division order with respect to oil removed from a property in December 1979 is required—within two weeks of a request in writing—to submit a statement to the present operator setting forth all facts which are known by the person and which bear upon the uncontrolled base period price. *Id.* In the absence of books or records permitting an accurate computation of the "uncontrolled base period price," the regulations require that the operator promptly request the statements provided for in Prop. Reg. § 150.4989-1(c)(2)(ii).

[67]Prop. Reg. § 150.4989-1(c)(3). The regulations state that "[p]rice adjustments shall not be taken into account absent clear and convincing evidence that the adjustments were fixed before March 1, 1980." *Id.*

[68]Prop. Reg. § 150.4989-1(c)(3)(i)-(ii). Under the Tier 2 and 3 post-September 30 base price rule, as set forth in the September 30 regulations, Treasury Decision 7721, 45 Fed. Reg. at 64574, the determination of the actual or constructive

The minimum base price for Tier 2 and Tier 3 oil under the regulations in effect after September 30, 1980, is determined from the ceiling price which would have been applied to the oil under the March 1979 DOE regulations if the crude oil had been produced and sold in May 1979 as upper tier oil. The upper tier ceiling price is multiplied by 1.1 to obtain the minimum base price for Tier 2, and by 1.2 to obtain the minimum base price for Tier 3. For purposes of making this determination, the producer must use the grade and quality of oil produced from the property in May 1979. The proposed regulations contain no provisions for adjustments to the base price to account for subsequent variations in API gravity.[69]

E. *Tax Rates*

The rates applied to taxable crude oil vary with the tier of the crude oil, as follows:[70]

	"Independent Producer Oil"	Other Non-Exempt Oil, Including Production of Integrated Oil Companies and Royalty Owners
Tier 1:	50 percent	70 percent
Tier 2:	30 percent	60 percent
Tier 3:	30 percent	30 percent

uncontrolled base period price was made on a reservoir—by—reservoir basis. The computation in the September 30 regulations can be described as follows. (Citations are to the September 30 regulations prior to amendment.)

Under the September 30 regulations, where oil is produced from a reservoir that produced oil sold (by or for the taxpayer) in uncontrolled sales during December 1979, the "uncontrolled base period price per barrel" for oil from that reservoir is the weighted average removal price per barrel of oil sold (by or for the taxpayer) from the reservoir in uncontrolled sales during the base period. This amount must be determined without regard to any price adjustments made after February 29, 1980. Prop. Reg. § 150.4989-1(c)(2).

A different rule applies to determine the base price of oil produced from a reservoir which did not produce oil sold by or for the taxpayer in uncontrolled base period sales. Under these circumstances, the transferor's base period price or the "constructive uncontrolled base period price" is used.

If the taxpayer received the property in a transfer after November 30, 1979, and the taxpayer's transferor made uncontrolled sales from the same reservoir during December 1979, the taxpayer's base price will be the base price which the reservoir would have had in the hands of the transferor. But, in order to use the transferor's base price for purposes of the tax, the taxpayer must obtain a written statement under penalties of perjury from the transferor (or the transferor's operator or first purchaser) setting forth the transferor's base price for Tier 2 or Tier 3 oil and all facts bearing upon the correctness of that base price. If the taxpayer does not obtain such a statement, the minimum base price specified in the regulations will apply. Prop. Reg. § 150.4989-1(c)(3)(i).

Where the taxpayer did not obtain the property by a transfer after November 30, 1979, and did not sell any crude oil from the reservoir in uncontrolled sales during December 1979, the base price will be determined from the "constructive uncontrolled base period price." The "constructive uncontrolled base period price" is the price that would have been obtained for the oil if it had been sold in uncontrolled sales by or for the taxpayer during the base period. The September 30 temporary regulations provide three means to compute this price, but if none of the three applies, the producer must use the minimum base price. (1) First, if oil of similar grade and quality was produced from the same reservoir and sold in uncontrolled sales during December 1979, then the taxpayer's "constructive uncontrolled base period price" is the representative market or field price of the oil. Prop. Reg. § 150.4989-1(c)(3)(ii)(A). (2) Second, if (a) the first method does not apply, and (b) oil of a similar grade and quality was sold or purchased by or for the taxpayer in uncontrolled sales or purchases during the base period, and (c) this oil was produced from the nearest reservoir for which oil of similar grade and quality was sold or purchased in uncontrolled sales during the base period, then the taxpayer's "constructive uncontrolled base price" is the weighted average removal price per barrel of such oil. Prop. Reg. § 150.4989-1(c)(3)(ii)(B). (3) If neither of the first two methods apply, then the taxpayer's "constructive uncontrolled base period price" is the representative market or field price of oil of similar grade or quality from the nearest reservoir from which such oil was produced and sold by or for a producer other than the taxpayer in uncontrolled sales during the base period. Prop. Reg. § 150.4989-1(c)(3)(ii)(C). If the taxpayer cannot make any of the above three determinations, then the tax must be computed on the basis of the minimum base price defined in the regulations, a result likely to be very unfavorable to the producer. *Id.*

[69]Prop. Reg. § 150.4989-1(c)(6).

[70]I.R.C. § 4987.

The existing DOE regulations incorporated into the "windfall profit" tax may provide producers a limited opportunity to designate properties to obtain more favorable tax treatment. Tier classifications rest upon existing price control concepts. Both in base price and tax rate, Tier 3 oil receives the most favorable tax treatment; Tier 1, the least. DOE regulations which permit designation of separate reservoirs may also permit a producer limited control of the tier of his oil under some circumstances. It should be noted, however, that the IRS has not specifically stated that existing price control concepts will be fully incorporated into the "windfall profit" tax.

Under DOE's present interpretation of its regulations, the price classification of crude oil depends upon the "property" from which it is produced. Since 1976, DOE regulations have defined "property" as

> the right to produce domestic crude oil which arises from a lease or from a fee interest. A producer may treat as a separate property each separate and distinct producing reservoir subject to the same right to produce crude oil, provided that such reservoir is recognized by the appropriate governmental regulatory authority as a producing formation that is separate and distinct from, and not in communication with, any producing formation.[71]

Under its present interpretation of the definition, DOE generally regards the premises of the lease or of the unit as the "property." However, where this "right to produce" contains more than one separate and distinct reservoir which has been so recognized by the appropriate governmental body, a producer may make a one-time election to treat each separate reservoir within the "right to produce" as a separate "right to produce," and thus, a separate property.

In some instances, the reservoir election may affect the price control category of the oil, and thus, apparently, its tier classification under the "windfall profit" tax. Consider, for example, a single lease producing upper tier crude oil and treated as a single property but containing two reservoirs. If production from one reservoir should decline to ten barrels or less per day at a maximum feasible rate of production, it may be advantageous for the operator to elect to treat each reservoir as a separate property. Under DOE's present interpretation of its "stripper well property" regulations, the declining reservoir, after one year of production averaging ten barrels or less per day, may then qualify as a "stripper well property," thus shifting its production into the more favorable tax rates for Tier 2 oil.[72]

In light of a recent DOE ruling, the tax results of a separate reservoir election would be even more pronounced where a "new" reservoir is tapped on an existing lease. For example, consider a lease treated as a single prop-

---

[71]10 C.F.R. § 212.72; *see* 41 Fed. Reg. 36171 (August 26, 1976).

[72]*See also* S. Meyer, "The Windfall Profit Tax -the Net Income Limitation," 2 *Oil & Gas Reg. Analyst* 2 (June 1980). If a recent district court decision is upheld on appeal, the results of such an election may be more immediately favorable. In *Southland Royalty Co. v. Federal Energy Admin.*, ____ F.Supp. ____, [1980] 4 CCH Energy Management ¶ 26,234 (N.D. Tex., August 11, 1980) the district court held that DOE's Ruling 1977-2 was substantively invalid in prohibiting a producer from qualifying a reservoir as a stripper well property based on the reservoir's production history prior to its being designated a separate property for pricing purposes. Under the court's decision, a separate reservoir apparently could become a stripper well property on the day it was designated a separate property, provided the reservoir itself had the requisite 12-month production history.

erty producing Tier 1 oil but having two separate, recognized reservoirs, one of which produced no crude oil in 1978. Under DOE's Ruling 1980-3, a separate, recognized reservoir which produced no crude oil in 1978 may be designated as a separate property after 1978 and then treated as a "newly discovered" property under 10 C.F.R. § 212.79. The fact that the reservoir was not designated as a separate property until after 1978 will not preclude it from being treated as a "newly discovered" property after the operator elects a separate designation, provided that no crude oil was produced from the reservoir in 1978. In the example above, one reservoir would continue to produce Tier 1 oil, while the other would produce "newly discovered" crude oil, treated as Tier 3 production and thus subject to more favorable tax treatment. If a workover of the Tier 1 reservoir were contemplated, additional tax savings might then be achieved by timing expenditures for maximum advantage under the 90-percent net income limitation, discussed below.

A caveat is in order concerning planning under the "windfall profit" tax, since the IRS has yet to issue any final regulations. The statute itself specifically incorporates DOE energy regulations as they existed at various fixed dates prior to passage of the "windfall profit" tax, but the statute is silent on the effect of DOE interpretations. Likewise, the legislative history of the Act does not definitively resolve the question of how judicial invalidation of incorporated DOE regulations will affect the standards applied for purposes of the tax. The statute gives the Secretary the power to alter the "energy regulations" to achieve the purposes of the tax. The temporary regulations specifically incorporate only one agency ruling, FEA Ruling 1977-1.[73] Whether the final regulations will incorporate the whole of DOE's construction of its regulations, including the refinements and clarifications made after the date of the specifically incorporated regulations, remains an open question, particularly since some subsequent DOE actions appear to conflict with the intent of Congress, as set forth in the legislative history of the Act.[74]

F. *"Independent Producer Oil"*

1. Defined

"Independent producer crude oil" in Tier 1 and Tier 2 is taxed at rates more favorable than those which apply to other production. The tax rate applied to independent producer crude oil is 50 percent for Tier 1 production and 30 percent for Tier 2. The term "independent producer" has a broad definition. In general, any working interest owner eligible for percentage depletion under Section 613A(c) of the Internal Revenue Code qualifies as an "independent producer" and, subject to the restrictions discussed below, crude oil which is attributable to his working interest in a qualified property

[73]42 Fed. Reg. 3628 (January 19, 1977); *see* Prop. Reg. § 150.4996-1(i).

[74]For example, DOE Ruling 1980-3 apparently would deny newly discovered crude oil status to properties with any 1978 production, while the Conference Report indicates that 1978 non-commercial production and production which is incident to test or exploratory wells, but not part of continuous or commercial production, does not affect the "newly discovered" status of the property. *See Conference Report*, at 97-98.

may qualify as "independent producer crude oil" under the "windfall profit" tax. Because a partner in a partnership is treated as the "producer" of the crude oil of the partnership which is proportionate to his share of the partnership's crude oil revenues, a limited partner may qualify as an "independent producer" for purposes of the reduced rate.

The term "independent producer oil" is defined as "that portion of an independent producer's qualified production for the quarter which does not exceed such person's independent producer amount for such quarter."[75] Whether a producer is an "independent producer" under the Act must be determined for each quarter. Generally, an independent producer is:

> any person other than a person to whom subsection (c) of section 613A does not apply by reason of paragraph (2) (relating to certain retailers) or paragraph (4) (relating to certain refiners) of section 613A(d).[76]

In other words, independent producer status must be determined generally in the same way that it must be determined for eligibility for percentage depletion under Section 613A(c). In applying Section 613A to determinations of independent producer status, the Internal Revenue Code standards must be applied for each quarter; that is, "quarter" is substituted for "taxable year" and "one million two-hundred and fifty thousand dollars" is substituted for "five million dollars" to determine whether the producer had revenues from retail operations sufficient to make him a "retailer" for the quarter and thus ineligible for independent producer rates in that quarter.

A producer is disqualified as a "refiner" if his refinery runs for any day during the quarter exceed 50,000 barrels. Thus, the independent producer definition for the "windfall profit" tax is not coextensive with the definition for percentage depletion purposes. A producer may be disqualified for independent producer rates for a quarter because he was a "retailer," yet not be disqualified for percentage depletion for the year. On the other hand, a producer whose refinery runs exceed 50,000 barrels on a single day during the year would be disqualified from independent producer rates for a single quarter, but would be disqualified from percentage depletion for the entire year.

The preferential tax rate for "independent producer oil" applies only to the first 1000 barrels of "qualified production" per day, determined quarterly. "Qualified production" includes only Tier 1 and Tier 2 oil. As discussed below, an independent producer receives only one 1000 barrels per day amount eligible for reduced rates. Therefore, if he produces both Tier 1 and Tier 2 oil, the 1000 barrels per day allowance must be allocated proportionally between the two categories based on production for the quarter.

2. "Qualified Production"

In order to classify as "qualified production of oil," and thus be eligible for reduced rates under the "windfall profit" tax, an independent producer's

[75] I.R.C. § 4992(a).
[76] I.R.C. § 4992(b)(1).

production must meet five qualifications: (1) the independent producer must be the "producer" of the oil; (2) the oil must have been removed during the quarter; (3) the oil must be either Tier 1 or Tier 2; (4) the oil must be attributable to the independent producer's working interest in a property; and (5) the oil must not be attributable to a property interest disqualified by operation of the transfer rules in the Act.

For purposes of determining "qualified production of oil," the "windfall profit" tax defines "working interest" as:

> an operating mineral interest (within the meaning of section 614(d))
> (i) which was in existence as such an interest on January 1, 1980, or
> (ii) which is attributable to a qualified overriding royalty interest.[77]

The Internal Revenue Code definition incorporated in the statute defines "operating mineral interest" to include:

> only an interest in respect of which the costs of production of the mineral are required to be taken in account by the taxpayer for purposes of computing the 50 percent limitation provided for in section 613, or would be so required if the mine, well, or other natural deposit were in the production stage.[78]

Thus, in order to qualify as a "working interest" under the Act, the interest must have been in existence as such on January 1, 1980, or must be attributable to a "qualified overriding royalty interest." Other royalty interests converted into working interests after that date apparently do not qualify for reduced rates.

Under the "windfall profit" tax, a "qualified overriding royalty interest" is an overriding royalty interest which existed as such on January 1, 1980, and for which there was in existence on February 20, 1980, a binding contract under which the interest was to be converted to an operating mineral interest within the meaning of Section 614(d). According to the explanatory statement in the Conference Report, this exception includes a qualified overriding royalty interest converted to a working interest between January 1, 1980, and February 20, 1980. The statute does not state that production attributable to a qualified overriding royalty interest can qualify prior to its actually being converted into a working interest.

Neither the statute nor the Conference Report defines the term "binding contract." After release of the Conference Report, many producers advanced the concern that overriding royalty interests which are converted by way of options granted to the holder would not constitute "qualified overriding royalty interests" under the Act. Senator Long, one of the sponsors of the Conference Bill, stated during Senate debate:

> we are not concerned with the technicality of how the overriding royalty interest was converted or could be converted to a working interest, as long as the conversion occurred pursuant to a contract in existence on February 20, 1980. We are concerned with the reality that it has been or is converted to a working interest.[79]

---

[77] I.R.C. § 4992(d)(2)(A).

[78] I.R.C. § 614(d).

[79] 126 CONG. REC. S3132 (daily ed. March 27, 1980).

Senator Long also stated:

> it does not make any difference whether the overriding royalty was convertible upon the option of the holder of the overriding royalty, or whether it was automatically converted upon the happening of some occurrence. The important fact is that an interest which did not previously pay part of the cost of operating or producing the property has become subject to payment of operating costs because it became a working interest and is no longer an overriding royalty.[80]

Senator Long's comments indicate that an interest which otherwise constituted a "qualified overriding royalty interest" under the statute would not be disqualified for lack of a mandatory conversion requirement in the contract. The statute itself, however, is silent on this point and the IRS proposed regulations essentially adopt the statutory language.[81]

"Qualified production of oil" eligible for "independent producer crude oil status" includes only Tier 1 and Tier 2 oil. Production of Tier 3 oil, even in excess of one thousand barrels, apparently will not affect an independent producer's "independent producer amount" of production eligible for reduced rates. If, however, a producer's qualified production for a quarter exceeds his independent producer amount for that quarter, the amount of crude oil eligible for reduced rates must be allocated between Tiers 1 and 2 in proportion to the producer's production of domestic crude oil in each tier during that quarter. Within each tier, the independent producer amount is to be allocated, beginning with the highest removal prices for oil within each tier.[82]

3. Members of Related Groups

Persons who are members of the "same related group" at any time during a particular quarter do not each receive a full 1,000 barrel per day independent producer amount for that quarter. Rather, a single 1,000 barrel per day amount must be allocated among all persons who were members of the same related group for the quarter. For purposes of this mandatory allocation rule, the following are considered "related groups": (1) a family (individual, spouse, and minor children), (2) a controlled group of corporations, (3) a group of entities under common control, and (4) all entities and the family where fifty percent or more of the beneficial interest in one or more corporations, trusts, or estates is owned by the same family. Under the fifty percent beneficial interest rule, an interest owned by or for a corporation, partnership, trust, or estate shall be considered as being owned directly by the entity and also proportionately by its shareholders, partners, or bene-

---

[80]*Id.*

[81]Comments filed with the IRS have requested clarification on this point and on the related issue of whether production attributable to a "qualified overriding royalty interest" can be eligible for reduced rates prior to conversion. *See, e.g.*, Comments of Arthur Andersen & Co., filed June 2, 1980, at 2.

[82]Prop. Reg. § 150.4992-1(c). The American Petroleum Institute has pointed out that revenue and production on outside operated properties may be recorded two to three months after the month of production. Thus, even though the operator had made timely withholdings and deposits of the tax, an independent producer might be required to reallocate his "independent producer amount—both between Tiers 1 and 2 and on the basis of removal prices within each tier—with each subsequent adjustment to his production figures. Accordingly, API suggested regulations establishing a cut-off for subsequent *de minimis* adjustments. *See* Comments of API, filed June 3, 1980, at 12-14; *see also* Comments of Basin, Inc., filed June 3, 1980, at 17 (commenting on the need for guidance on the tier allocation formula and a clarification of the responsibilities of producers and first purchasers).

ficiaries. Persons who are members of more than one related group during any quarter will determine their allocated share of an "independent producer's amount" by considering themselves to be members only of the related group which produces the smallest "independent producer's amount."[83]

4. Transfer Restrictions and "Independent Producer Oil"

a. *General Rule of Disqualification*

The "windfall profit" tax contains provisions designed to prevent the transfer of properties for the purpose of obtaining more favorable tax treatment under the preferential rates for independent producer crude oil. The statute establishes a general rule that where a property interest is transferred on or after January 1, 1980, none of the transferee's production attributable to the interest will be "qualified production," and thus none of the production will be eligible for reduced "independent producer oil" rates.[84] This rule is subject to several exceptions, the most significant being the "small producer transfer exemption." A transfer includes a sublease, and an interest in a partnership or a trust is treated as an interest in property held by the partnership or trust. Thus, a sublease or a transfer of an interest in a partnership or trust may result in the application of the general rule of disqualification, subject to certain exemptions discussed below.[85]

b. *"Small Producer Transfer" Exemption*

i. Defined

The "small producer transfer exemption" permits independent producers who do not exceed their independent producer amounts to transfer a property interest without the transferee losing qualified status for the interest. Under this exception, the general rule of disqualification shall not apply:

> to any transfer of an interest in property if the transferee establishes (in such manner as may be prescribed by the Secretary by regulations) that at no time after December 31, 1979, has the property been held by a person who is a disqualified transferor for any quarter ending after September 30, 1979, and ending before the day such person transferred the interest.[86]

The exemption is not available if the property interest has been held after December 31, 1979, by a "disqualified transferor." Neither the statute nor the regulations appear to require that the status of the transferee be considered in determining whether production from the property interest would be ineligible for "independent producer oil" rates by reason of the transfer. Of course, the status of the transferee would be relevant to determining

---

[83] I.R.C. § 4992(e).

[84] I.R.C. § 4992(d)(3)(A) provides:

Except as otherwise provided in this paragraph, in the case of a transfer on or after January 1, 1980, of an interest in any property, the qualified production of the transferee shall not include any production attributable to such interests.

[85] I.R.C. § 4992(d)(3)(D).

[86] I.R.C. § 4992(d)(3)(B).

whether he himself would qualify as an "independent producer" eligible for the reduced rates.

Under the temporary regulations, the transfer of an otherwise qualified property interest falls within the small producer transfer exemption if the transferee demonstrates to the satisfaction of the IRS District Director of the district where the property is located that at no time after December 31, 1979, has the property been held by a person who was a "disqualified transferor" for any quarter ending after September 30, 1979, and for any subsequent quarter ending before the date the interest was transferred.[87] For purposes of the small producer transfer exemption, a person is a "disqualified transferor" for a particular quarter if either he was not an independent producer or he exceeded his independent producer amount for that quarter.[88]

To determine whether the exemption applies, properties held by partnerships are treated as owned proportionately by the partners. Properties held by trusts or estates are treated as owned both by the trust or estate and proportionately by the beneficiaries. The statutory provisions concerning disqualified transferors apply to interests held after September 30, 1979, for purposes of determining whether the small producer transfer exemption applies.[89] Thus, to determine whether a transferred property interest qualifies for the reduced rates available for independent producer oil, a producer may need to determine the status of the persons who have held that interest from October 1, 1979, through the quarter immediately preceding the date of transfer.[90]

Production from many property interests may be ineligible for "independent producer oil" rates even though a small producer held the property interest when the "windfall profit" tax became effective. For example, a property interest transferred to a small producer in January 1980 by an independent producer who produced more than 1,000 barrels of oil per day during the fourth quarter of 1979 apparently would be ineligible for reduced rates. The general rule that transferred interests are ineligible for independent producer rates would apply since the transfer took place on or after January 1, 1980. The small producer transfer exemption apparently would not be available since the property would have been held after December 31, 1979, by a person who was a disqualified transferor in the fourth quarter of 1979, a quarter ending before the date the interest was transferred.

Several aspects of this rule should be noted. First, the "disqualified transferor" status of a prior holder of the property must be determined on a quarterly basis. Thus, if an independent producer held the property interest

---

[87]Prop. Reg. § 150.4992-1(d)(3)(ii).

[88]I.R.C. § 4992(d)(3)(B)(ii).

[89]Prop. Reg. § 150.4992-1(d)(3)(ii)(C).

[90]The small producer transfer exemption states that the general rule of disqualification shall not apply to any transfer of an *"interest in property,"* provided "that at no time after December 31, 1979, has *the property* been held by a person who was a disqualified transferor." Arguably, this provision could be read as disqualifying any transferred property interest where any portion of the entire DOE property has been held by a disqualified transferor during the specified time. Because this reading would produce an anomalous result, it is likely that use of the term "the property" rather than "the property interest" was merely inadvertent. The proposed regulations essentially follow the statutory language. Prop. Reg. § 150.4992-1(d)(3)(ii).

during a quarter in which he exceeded his independent producer amount and then transferred it after the end of the quarter, the transferred interest would be ineligible for reduced rates in the hands of the transferee.

Additionally, it appears that if a qualified transferor should transfer the property interest to an independent producer who had exceeded his independent producer amount (such that he himself would be a disqualified transferor), the property will remain eligible for reduced rates in the hands of the transferee. The Act apparently does not require that the status of the transferee be considered in determining whether a property would be ineligible for independent producer oil rates by reason of the transfer. Of course, in such a situation the transferee could not pass on eligible status in subsequent transfers, since in subsequent transfers the property would have been held by a disqualified transferor.

The statute and the Conference Committee Report indicate that a property interest may be ineligible for the small producer transfer exemption if a prior holder of the property interest was a disqualified transferor for any full quarter after September 30, 1979, even if the prior holder was not a disqualified transferor for the particular quarter or quarters during which he held the interest. To prove eligibility for the exemption, the producer must show that at no time after December 31, 1979, has the property been held by "a person who was a disqualified transferor *for any quarter* ending after September 30, 1979, and ending before the date such person transferred the interest."[91] The statute does not expressly limit disqualification to situations where a prior holder was disqualified during a quarter in which he held the property interest.

ii. Treatment of Trust and Partnership Interests

The transfer restrictions in the "windfall profit" tax are subject to several special rules. Property held by a partnership at any time shall be treated as owned proportionately by the partners.[92] The statute does not explicitly state what effect this provision would have on the transfer of partnership property. A question could arise where one or more but not all members of the partnership were disqualified transferors and the partnership's working interest in a property was transferred as a whole. It appears that such a transfer would be treated as if it were a sale of each partner's allocable share of the working interest in the transferred property. Thus, where one or more partners were disqualified transferors, the working interest transferred by the partnership would be proportionally disqualified from reduced rates for independent producer crude oil.

Additionally, for purposes of the small producer transfer exemption, property held by any trust or estate is treated as owned both by the trust or estate and proportionately by its beneficiaries.[93] Therefore, the question whether a trust or estate is a disqualified transferor must be considered at

[91] I.R.C. § 4992(d)(3)(B)(i).
[92] I.R.C. § 4992(d)(3)(B)(iii)(I).
[93] I.R.C. § 4992(d)(3)(B)(iii)(II).

two levels. First, if the trust or estate itself has exceeded its independent producer amount during a relevant quarter, the trust or estate will be a disqualified transferor with respect to the otherwise qualified property interest it holds. Second, if the trust itself has not exceeded its independent producer amount but individual beneficiaries of the trust, through their other interests, have exceeded their independent amounts in a given quarter, it appears that the trust property could be transferred without the complete loss of its eligibility for independent producer rates in the hands of the transferee. In all likelihood, this rule would result in the proportionate disqualification of a property where some but not all beneficiaries have exceeded their independent producers amount during a relevant quarter.[94]

The special rules governing application of the small producer's transfer exemption to trust, estate, and partnership property are treated as applying after September 30, 1979, for purposes of determining whether a property interest has been held by a disqualified transferor.[95]

c. *Other Transfer Exemptions*

In addition to the small producer transfer exemption, the statute provides three other exceptions to the general rule disqualifying transferred properties. Transfers of property at death are exempt, as are changes in the beneficiaries of certain qualifying trusts. Members of the "same related group" who allocate among themselves a single 1,000 barrel per day independent producer amount may transfer properties among themselves without disqualification of the property. These three exemptions are available only if production from the transferred property was qualified production for the transferor.

G. *State Severance Tax Adjustment*

In computing the "windfall profit" tax, producers may increase the adjusted base price of a barrel of crude oil by the amount of qualifying state severance taxes (but not local severance taxes) imposed on the "windfall profit" element of the sales price.[96] In other words, the severance tax adjustment with respect to any barrel of crude oil is the amount by which the severance tax imposed on the barrel exceeds the amount which would have been imposed if the barrel had been valued at its adjusted base price.

The temporary regulations define a "severance tax" as a tax which is imposed by a State on the extraction of crude oil and which is determined on the basis of the gross value of the extracted oil. Taxes levied on reserves in the ground or on net proceeds of production and taxes levied as a fixed fee per barrel are not "severance taxes" under this definition, and no adjustment

---

[94]It should be noted that if 50 percent or more of the beneficial interest in one or more corporations, trusts, or estates is owned by the same family, all such entities and such family will be considered related persons for purposes of determining the independent producer crude oil amount and will be required to allocate a single one thousand barrel per day per quarter amount among themselves in proportion to their relative shares of production from the related interest. I.R.C. § 4992(e).

[95]I.R.C. § 4992(d)(3)(B)(iii)(III).

[96]I.R.C. §§ 4988(a)(2); 4996(c).

may be made for such taxes.[97] Additionally, no adjustment may be taken to the extent the state severance tax rate exceeds 15 percent of the value of a barrel of crude oil. Increases in state severance taxes after March 31, 1979, may not be taken into account in computing the adjustment, unless the increase is an increase in rate (or the initial imposition of a severance tax) which applies equally to all portions of the gross value of each barrel of crude oil subject to the tax.[98]

In a recent Revenue Ruling, the IRS held that a related income tax credit or refund must also be taken into account in determining whether a state "severance" tax is levied on the basis of the gross value of the extracted oil. At issue in Revenue Ruling 80-217 (released August 11, 1980), was an unidentified state privilege tax coupled with a credit or refund based on the "windfall profit" element of the revenue produced by a barrel of oil. Under the tax, removal of crude oil would be subject to a tax based on 15 percent of the gross value of the oil at the wellhead. Considered alone, this levy would qualify as a "severance tax" under the "windfall profit" tax. However, under the state tax scheme, the taxpayer would receive a state tax credit equal to the amount of the privilege tax imposed, less the difference between (1) the federal "windfall profit" tax computed with the severance tax adjustment and (2) the federal "windfall profit" tax computed without the severance tax adjustment. The excess of the credit above the taxpayer's state income tax liability for the year would then be refundable by the state.

The IRS noted in Revenue Ruling 80-217 that the effect of the tax at issue would be to impose a net tax equal to the state's tax rate multiplied by the amount of a producer's federal "windfall profit" tax liability computed without a severance tax adjustment. Based on a joint analysis of the state privilege tax and the accompanying state tax credit provisions, the IRS concluded that the tax was not imposed on the gross value of the extracted oil and thus did not meet the requirements for the severance tax adjustment and could not be taken into account in determining the "windfall profit" amount. Thus, Revenue Ruling 80-217 suggests that the IRS will take a careful look at the net effect of state taxes in deciding whether they may be taken into account in computing the "windfall amount."[99]

H. *Net Income Limitation*

The statute provides that the "windfall profit" on any barrel of crude oil shall not exceed 90 percent of the net income attributable to it.[100] However, a producer may not have his withholding adjusted to take account of the 90-percent net income limitation.[101]

To determine the net income attributable to a barrel of oil, the taxable income attributable to taxable oil from a "property" for the taxable year is

---

[97]Prop. Reg. § 150.4996-2(a)-(b).

[98]Prop. Reg. § 150.4996-2(c).

[99]The Independent Oil and Gas Association of West Virginia ("IOGA") has urged the IRS to issue a Revenue Procedure listing those state taxes which qualify as "severance taxes" under the "windfall profit" tax. Comments of IOGA, filed May 15, 1980, at 4; *see also* Comments of Koch Oil Co., filed June 2, 1980, at 28-29.

[100]I.R.C. § 4988(b).

[101]Prop. Reg. § 150.4995-1(c).

divided by the number of taxable barrels produced.[102] The definition of "property" for purposes of calculating the net income limitation is not the DOE property definition used in computing the "windfall profits" tax, but the definition used in Section 614 of the Internal Revenue Code.[103]

For purposes of determining the availability of the 90 percent net income limitation, the producer's taxable income from the property is determined under I.R.C. § 613(a).[104] However, in computing the net income for the property, the producer may not deduct

(i) depletion,
(ii) the tax imposed by section 4986 ["windfall profit" tax],
(iii) section 263(c) costs [intangible drilling and development costs, excluding costs incurred in drilling non-productive wells], or
(iv) qualified tertiary injectant expenses to which an election under subparagraph (E) applies.[105]

The statute permits the net income, computed as discussed above, to be further reduced essentially by calculating and deducting an imputed amount for cost depletion. Under I.R.C. § 4998(b)(3)(C), the producer may reduce his net income from a property by the cost depletion amount which would have been allowable for the taxable year if the taxpayer had used cost depletion for the property during all taxable periods and had capitalized intangible drilling and development costs and qualified tertiary injectant expenses.[106] In order to take advantage of this deduction, the producer obviously must be able to substantiate his tax basis for his interest in the property. This deduction is available even if the producer used percentage depletion on his tax return. Intangible drilling and development costs ("section 263(c) costs") do not include costs incurred in drilling a non-productive well.

I.R.C. § 4998(b)(4) is aimed at preventing producers from increasing the imputed cost depletion amount for proven oil and gas properties through transfers. Absent this provision, producers could increase the depletable basis of properties through transfers and thus—by operation of the net income limitation—reduce the amount of the "windfall profit" tax. The limitation in I.R.C. § 4998(b)(4) applies to transfers of "proven oil and gas properties" and provides essentially that the transferee's basis for cost depletion is the transferor's basis, increased only by expenditures taking place after the transfer. The term "proven oil and gas property transfer" is defined as any post-1978 transfer of an economic interest in the property, including a sublease or a production payment.

The 90-percent net income provision may directly affect the relative attractiveness of drilling prospects. In many situations, it may permit a sub-

[102] I.R.C. § 4988(b)(2).

[103] Section 614(a) of the Internal Revenue Code states:

> [T]he term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

While the regulatory direction under DOE price controls generally has been on preventing separation of "properties," the IRS emphasis generally has been on preventing combinations of properties.

[104] I.R.C. § 4988(b)(3)(A).

[105] I.R.C. § 4988(b)(3)(B).

[106] I.R.C. § 4988(b)(3)(E). Allows a taxpayer to elect to capitalize qualified tertiary injectant expenses. The election applies to all qualified expenses allocable to the property for which the election is made and may be revoked only with consent of the Secretary. The election is made in the first year that injectants are used on the property.

stantial portion of workover and dry-hole expenses to be used to offset "windfall profit" tax liability.

I. *Deductibility of Windfall Profit Tax*

The "windfall profits" tax may be deducted on a taxpayer's federal income tax return. The amount of "windfall profits" tax paid may be treated as a deduction pursuant to Section 164 of the Internal Revenue Code.[107]

J. *Phase-out of the Tax*

The "windfall profit" tax will begin to phase out when the Secretary of the Treasury estimates that aggregate net "windfall" revenues exceed $227.3 billion. Regardless of revenues collected, this phase-out will begin no earlier than January 1988, nor later than January 1991. The tax will phase out over a 33-month period during which each producer's tax will be reduced by three percent per month. Thus, the 33-month phase out period will significantly increase the total revenues raised by the tax.[108] For the quarter ending with June 1980, the IRS reported "windfall profit" tax collections in the amount of $447,517,000.[109]

IV. Administration of the Tax

The Act gives the Secretary of Treasury authority to issue regulations to implement the tax.[110] Key administrative provisions in the statute and the temporary regulations are summarized below.

A. *Overview of Provisions on Withholding and Depositing the Tax*

Under the "windfall profit" tax and the temporary regulations of the IRS, the first purchaser of crude oil has the primary burden of withholding and depositing the tax, except for amounts attributable to the interests of an integrated oil company and certain other categories of crude oil not subject to withholding.[111] To fulfill the duty of withholding and depositing the tax, the first purchaser must have a substantial amount of information from other parties.

Producers eligible for an exemption or for special "independent producer" rates must furnish a certificate ("producer's certificate") to the first purchaser or to the operator of the property.[112] If the operator receives the certificates, he must furnish them or certify their contents to the first purchaser.[113] If payments for the oil are made to a partnership, the producer must send his certificate to the partnership, which must then certify to the first purchaser or operator the percentage of crude oil attributable to the partnership interest which is exempt or subject to a lower rate of tax.[114]

---

[107] I.R.C. § 164(a)(5).
[108] I.R.C. § 4990; *Conference Report* at 116.
[109] Source: Internal Revenue Collections of Excise Taxes, Summary for Quarter ended June and fiscal year 1980.
[110] I.R.C. § 4997(b).
[111] I.R.C. §§ 4995(a)(1); 4995(b)(1).
[112] Prop. Reg. § 150.4995-1(b)(3).
[113] Prop. Reg. § 150.6050C-1(f).
[114] Prop. Reg. §§ 150.4995-1(c)(3)(ii), 150.4995-2(e).

The operator must furnish a separate monthly statement ("operator's certificate") to the first purchaser certifying the tier, amount, base price, severance tax adjustment, Trans-Alaskan Pipeline System ("TAPS") adjustment for the oil and the property from which the oil was removed.[115]

Based on the certificates furnished by the producers (either directly or indirectly through the operator and/or a partnership) and by the operator, the first purchaser must compute the amount of "windfall profit" tax to be withheld and deposit the tax in a qualified depository.[116] Under limited circumstances, the operator can elect to take the duties of withholding and depositing the tax.[117]

The first purchaser must file a quarterly "windfall profit" tax return reporting, among other things, the amount of oil removed, the amount of tax withheld and deposited, and any withholding adjustments.[118] The first purchaser must also furnish a monthly statement to each producer (or operator or partnership) to which he has made payments showing the total amount of "windfall profit" tax withheld in the particular month.[119] Additionally, the first purchaser must furnish a yearly statement of "windfall profit" tax liability and "windfall profit" tax deduction to the IRS and to each producer, operator, or partnership to whom the purchaser made payments during the calendar year.[120] For certain categories of oil not subject to withholding, the producer is responsible to depositing the amount of the tax and must file quarterly returns.[121] Also, each producer whose "windfall profit" tax liability exceeds the amount withheld for the calendar year must file an annual "windfall profit" tax return.[122]

Based on the information provided to him by the first purchaser and his own records, a producer may claim a credit or refund based on the net income limitation for any amounts of "windfall profit" tax overpaid.[123] No withholding adjustments can be made to account for the net income limitation; however, for integrated oil companies and for certain other producers' production which is not subject to withholding, the net income limitation may be taken into account in determining the amount of deposit required.[124]

For the most part, first purchasers will not withhold tax attributable to the interests of integrated producers, who have a separate obligation to make semi-monthly deposits of their estimated "windfall profit" tax liability.[125]

1. Production Not Subject to Withholding

The temporary regulations define three instances in which crude oil revenue will not be subject to withholding by the first purchaser: (1) where

---

[115] I.R.C. § 6050C; Prop. Reg. § 150.6050C-1.
[116] I.R.C. § 4995(b).
[117] I.R.C. § 4995(a)(7); Prop. Reg. § 150.4995-4.
[118] Prop. Reg. § 150.4997-1(a).
[119] Prop. Reg. § 150.4997-2(a)-(b).
[120] Prop. Reg. § 150.4997-2(c).
[121] Prop. Reg. §§ 150.4995-1(a), 150.4995-3(f), 150-4997-1(a)(1).
[122] Prop. Reg. § 150.4997-1(a)(2).
[123] Prop. Reg. § 150.6402-1.
[124] I.R.C. § 4995(a)(2)(B); Prop. Reg. § 150.4995-3.
[125] I.R.C. § 4995(b)(1); Prop. Reg. § 150.4995-3(a).

the oil is removed from the premises before it is sold, (2) where the manufacture or conversion of crude oil into refined products begins before the oil is removed from the premises or (3) where the producer is an "integrated oil company" as defined in the temporary regulations.[126] Where withholding is not required, the producer must deposit the tax as provided in the temporary regulations.

The April 25, 1980, amendments to the IRS temporary regulations[127] were an attempt to clarify the obligations of first purchasers who had expressed difficulty in determining whether producers owning an interest in particular properties were integrated oil companies not subject to withholding. Under the general rule in those amendments, the first purchaser must withhold the tax from revenues distributed to a producer unless he has received a certificate which identifies the producer as an integrated oil company. Withholding is improper after receipt of the certificate.[128] The integrated oil company must furnish a certificate to the producer and, thus, must deposit the tax, if the integrated oil company is the operator of the property.[129] In other instances, the integrated oil company may either choose to furnish a certificate, in which case the first purchaser will not withhold the tax; or, it may decline to furnish a certificate, in which case the first purchaser will withhold the tax and deposit it.[130]

The amended temporary regulations contain a special interim provision which will apply until 30 days after the publication of final regulations.[131] Until the first purchaser receives an integrated oil company's certificate, he may elect either to withhold or not to withhold the tax. The obligation of the integrated oil company producer to deposit its own tax is imposed if the first purchaser chooses not to withhold. However, if the integrated oil company is the operator of the property from which the oil is produced, it must furnish a certificate to the first purchaser, after which withholding by the first purchaser would be improper. The interim rule interacts with the general rule so that if the integrated oil company is not the operator of the property, the company will deposit its own tax (1) if it elects to furnish a certificate to

[126]Prop. Reg. § 150.4995-1(a). For purposes of withholding and depositing the tax, the statute and the temporary regulations define an "integrated oil company" as a company which produces crude oil and is also a "refiner" or a "retailer," but is not an "independent refiner." A company is not considered a retailer if its combined gross receipts (including related parties) from sale of oil, natural gas, or derived products are less than $1,250,000 during a quarter, and it is not considered a refiner if its refinery runs (including related persons) do not exceed 50,000 barrels on any day during the quarter. I.R.C. § 4995(b)(3); Prop. Reg. § 150.4996-1(g). Under the definition of "integrated oil company' in the "windfall profit" tax, a company might be an "integrated oil company" for three quarters during the year, but not for the fourth, and thus its depositary and withholding obligations would differ from quarter to quarter. One suggestion submitted to the IRS is to give a company in this situation the option to make its own deposits under the "integrated oil company" rules for the entire calendar year. *See* Comments of Coopers & Lybrand, filed June 3, 1980.

"Independent refiner" has the same meaning as the term used in section 3, paragraph 3, of the Emergency Petroleum Allocation Act of 1973, Pub. L. 93-159, as it existed on January 1, 1980, except that the classification is applied on a quarterly basis rather than as of the effective date of the EPAA. The definition as it appears in the proposed regulations is discussed *infra*, note 179 and accompanying text.

[127]45 Fed. Reg. 27929 (April 25, 1980).

[128]Prop. Reg. § 150.4995-1.

[129]Prop. Reg. § 150.4995-2(c)(2)(i).

[130]Prop. Reg. §§ 150.4995-1; 150.4995-2(c)(2)(ii).

[131]Prop. Reg. § 150.4995-1(a)(3).

the first purchaser or (2) if, while the interim rule applies, the first purchaser elects not to withhold.

In short, without regard to whether the integrated oil company has furnished a certificate, the interim rule permits the first purchaser to elect to have the integrated oil company to make its own deposits. But, in any event, the integrated producer may elect to make its own deposits and must do so if it is the operator of the property.

2. *Responsibility of First Purchaser for Withholding*

Generally, the first purchaser will have the burden of withholding and depositing the tax.[132] Computation of proper withholding amounts under the "windfall profit" tax requires information which will not usually be in the hands of the first purchaser, such as exempt status and eligibility for reduced rates for "independent producer oil." Accordingly, the statute and the temporary regulations impose obligations on producers and operators to furnish necessary information to first purchasers through certifications.

In addition to the integrated oil company's certificate[133] discussed above, the temporary regulations provide for two other certificates to the first purchaser: (1) the operator's certificate, which provides the basic information about the crude oil required to compute the tax;[134] and (2) the producer's certificate, which is required for eligible producers to take advantage of the reduced rates provided for independent producer crude oil or exemptions from the tax.[135] A first purchaser who fails to receive a timely certificate must withhold the tax at maximum rates specified in the temporary regulations.[136]

First purchasers are required to furnish monthly information statements and an annual information return to producers. The annual statement, termed the yearly statement of windfall profit tax liability and windfall profit tax deduction, must also be filed with the IRS.[137] If payments are made to a partnership or an operator rather than directly to the producer, the first purchaser must furnish the information to the partnership or operator, respectively. The monthly statement showing the windfall profit tax withheld for the month must be furnished to the producer by the first day of the second month after the reporting month.[138]

The yearly statement of windfall profit tax liability and windfall profit tax deduction is due on January 31, after the close of the calendar year dur-

[132]Under some circumstances, it may be difficult to determine who is intended to be the "first purchaser" under the temporary regulations. Comments have focused on the definition of the first purchaser in exchange and transportation arrangements and in instances where the division order for a lease casts the relationship between the holder of the order and the interest owners as a buy-sell arrangement. *See e.g.,* Comments of Terra Resources, Inc., filed May 28, 1980, at 4-7; Comments of the American Petroleum Institute ("API"), filed July 3, 1980, at 1-8; Comments of Koch Oil Co., filed June 2, 1980, at 27-28.

[133]Prop. Reg. § 150.4995-2(c)(2).

[134]Prop. Reg. § 150.6050C-1.

[135]Prop. Reg. § 150.4995-2(b), (c)(1).

[136]Prop. Reg. §§ 150.4995-1(b)(1)-(2) (absent, incomplete, or erroneous operator's certificate), 150.4995-1(b)(3) (absent, incomplete, or erroneous exemption certificate or independent producer's certificate).

[137]Prop. Reg. § 150.4997-2(a)-(c).

[138]Prop. Reg. § 150.4997-2(b).

ing which the oil was removed.[139] The first purchaser must furnish a separate yearly information return for each producer, operator, or partnership to which he made payments for oil purchased during the calendar year. The statement will include the quantity, removal price, adjusted base price, and windfall profit tax liability for the year, both in total and for each tier of oil. The statement will also explain any withholding adjustments not completed during the calendar year. The statement of windfall profit tax deduction will set forth the amount of "windfall profit" tax withheld by the first purchaser and deductible on the producer's federal income tax return. IRS Form 6248 will be used for this purpose.[140]

3. *Joint Election for Operator To Assume Deposit and Withholding Obligations of First Purchaser*

The statute provides that the first purchaser and the operator of a property may jointly elect to substitute the operator for the first purchaser for purposes of the withholding and depositary requirements, except as prohibited by regulation.[141] The temporary regulations severely restrict this substitution by providing that a joint election is invalid unless the operator is already required to make deposits as a purchaser of crude oil from a different reservoir.[142]

To make the election where it is permitted, the parties must execute a document, signed and dated by both parties, which states that both parties have agreed that the operator will assume responsibility for withholding and deposits. The operator must also assume responsibility for monthly and yearly statements to producers.[143] Each party must send a copy of the document within 10 days to the IRS Service Center for the region in which it files its federal income tax. The election is effective on the date of execution and remains in effect until at least 60 days after either party executes a termination document and delivers it to the other, unless both parties agree to an earlier termination date. The termination document also must be filed with the IRS within 10 days after execution.[145]

B. *The Producer's Certificate*

For crude oil that is subject to withholding, the producer must furnish a producer's certificate to establish his eligibility for an exemption or for reduced rates for "independent producer crude oil." The temporary regulations provide that the producer may furnish the producer's certificate to the first purchaser or operator of the property.[146] The operator has the obliga-

---

[139]Prop. Reg. § 150.4997-2(c)(5).

[140]Prop. Reg. § 150.4997-2(c).

[141]I.R.C. § 4995(a)(7).

[142]Prop. Reg. § 150.4995-4(a). Several parties have commented that the holder of the basic division order on a particular least—generally the operator—should be responsible for withholding the tax, because he will already have most of the necessary information. As noted in the Comments of the American Petroleum Institute, filed June 3, 1980, division orders themselves may cast the relationship between the holder of the order and other interest owners as a buy-sell arrangement.

[143]Prop. Reg. § 150.4995-4(a).

[144]Prop. Reg. § 150.4995-4(b).

[145]*Id.*

[146]Prop. Reg. § 150.4995-2(a).

tion to furnish the certificate or to certify its contents to the first purchaser. However, where the first purchaser pays a partnership rather than the individual partners for crude oil, the producer must furnish his producer's certificate to the partnership. The partnership then must furnish the first purchaser with a certificate stating the percentage of the oil attributable to the partnership which is exempt or subject to a lower rate of tax. The partnership may certify crude oil as exempt or as "independent producer oil" only to the extent that the partnership has received proper certifications from its partners, who are the "producers" under the statute. The regulations provide for the partnership to retain the certifications furnished it by its partners "for so long as material in the administration of any internal revenue law."[147] If the operator and the first purchaser have made a valid election that the operator will assume the duties of withholding and depositing the tax, the first purchaser must forward to the operator all certificates (or notices of revocation of certificates) received after the election.[148]

The producer's certificate must set forth facts establishing the producer's eligibility for exemption or lower rates; must identify the producer by name, address, and employer identification or social security number; and must be signed by the producer under penalties for perjury (except in the case of a revocation).[149] An exempt producer must also file an exemption certificate with the IRS Service Center for the region where the producer's income tax is filed.[150] An independent producer's certificate must state that the entire amount of the producer's oil expected to be sold to the purchaser is "independent producer oil," subject to reduced rates. If a producer discovers that a certificate is incorrect or that crude oil covered by a certificate no longer is eligible for an exemption or reduced rates, he must give his first purchaser notice of revocation of the certificate within 10 days.[151]

The temporary regulations have been criticized for containing language which could be construed to prevent some independent producers from taking full advantage of reduced withholding for "independent producer oil." The temporary regulations provide that an independent producer's certificate shall certify "that the *entire amount* of the producer's oil expected to be sold to the purchaser . . . constitutes 'independent producer oil.'"[152] The regulations also state:

> No certificate may be furnished with respect to oil if it is reasonable to believe that the number of barrels to be affected by the certificate, taken together with all other oil with respect to which a certificate has been furnished by the producer to any operator, purchaser, or partnership, will exceed the producer's independent producer amount. . . .[153]

Thus, the regulations contain no express provision permitting a producer to

[147] Prop. Reg. § 150.4995-2(e).
[148] Prop. Reg. § 150.4995-2(f).
[149] Prop. Reg. § 150.4995-2(a).
[150] Prop. Reg. § 150.4995-2(b).
[151] Prop. Reg. § 150.4995-2(c)-(d).
[152] Prop. Reg. § 150.4995-2(c).
[153] *Id.*

certify to a single purchaser that a percentage of the oil sold or the production from particular properties is eligible. If limited certifications are not permitted, some independent producers may be subject to excessive withholding which, in turn, would require first purchasers to make adjustments in subsequent quarters.[154]

C. *The Operator's Certificate and Other Obligations of the Operator*

The temporary regulations require the operator[155] of a crude oil property to furnish the first purchaser with an operator's certificate each month. The operator's certificate must be furnished to the first purchaser (or in some instances, to the producer or a partnership) no later than the fifteenth day of the month following the month in which the oil was removed. The operator's certificate will supply information about crude oil removed from the property in the month which is necessary for the first purchaser to compute the amount to withhold from revenues. If the first purchaser is required to withhold the tax, the operator must furnish the certificate to the first purchaser; otherwise, he furnishes the certificate to the producer. Thus, for example, where the producer is an integrated oil company which deposits its own tax on the oil or where the oil falls into another category of oil not subject to withholding, the operator must furnish a certificate to the producer. If the certificate is to be furnished to a producer who is a partner in a partnership, the operator may furnish the certificate to the partnership instead if the producer and the partnership agree. The partnership must then furnish the information to the producer within 15 days after receipt.[156] Where the operator and the first purchaser have made a valid election for the operator to assume the first purchaser's withholding and deposit obligation, the operator's certificate is not required for oil that is subject to withholding.[157]

The operator's certificate must contain the following information for the property for the reporting month: (1) the tier of the crude oil removed (For Tier 3 crude oil, the operator must state whether the oil is heavy oil, newly discovered oil, or incremental tertiary oil.); (2) the amount of crude oil removed, both in total and for each tier and category; (3) the adjusted base price for each tier of oil removed; (4) the severance tax adjustment, if any, for each tier; (5) the TAPS (Trans-Alaskan Pipeline System) adjustment, if any, and the average removal price for the month for Sadlerochit crude oil,[158]

---

[154] A number of comments filed with the IRS have called for clarification or revision of this section of the proposed rules. *See e.g.,* Comments of Arthur Andersen & Co., filed June 2, 1980, at 3-4; Comments of Koch Oil Co., filed June 2, 1980, at 24 (suggesting certification of eligibility on property-by-property basis); Comments of Charter Oil Co., filed June 2, 1980 at 3.

[155] The "operator" of a crude oil property is defined in the temporary regulations as

> the person that holds an operating mineral interest in the property and bears more of the responsibility for the management and operation of crude oil production from the property than any other holder of such an interest. In the case of a business entity, the operator is the entity and not its employee or owner.

Prop. Reg. § 150.4996-1(c). Subject to certain limitations, another person may be designated as the operator, with the written approval of the IRS District Director for the district where the property is situated.

[156] Prop. Reg. § 150.6050C-1(a).

[157] Prop. Reg. § 150.6050C-1(e).

[158] This requirement applies only to Alaskan crude oil.

and (6) the property from which the crude oil was removed.[159]

The operator may agree with the producer or purchaser that the operator will not furnish the operator's certificate or some portion of it, provided that the producer or purchaser has all the information necessary to compute, withhold, and deposit the tax.[160] Any party may unilaterally revoke such an agreement through written notice to the other party.

The operator must forward to the first purchaser any producer's certificates sent to him or certify the information to the first purchaser for purposes of determining eligibility for independent producer oil rates.[161]

Additionally, if the operator is an integrated oil company, the temporary regulations require that it furnish the first purchaser with an integrated oil company's certificate. This certificate will direct the first purchaser not to withhold on the integrated oil company's share of production and will have the effect of making the integrated oil company responsible for depositing its own tax.[162]

D. *Amounts Required To Be Withheld*

Under the temporary regulations, the amounts to be withheld from a producer's revenues are determined essentially in the same manner that the tax is calculated, but without regard to the 90-percent net income limitation.[163] A special rule requiring very high withholding applies where the operator has not furnished a valid operator's certificate. If an exempt producer or an independent producer fails to furnish a valid producer's certificate, the first purchaser must withhold based on the full tax rate applicable to integrated oil companies and royalty owners.

Under the temporary regulations, the first purchaser must adjust the amounts withheld from a producer's revenues if he ascertains that either more or less than the proper amount has been withheld. The net income limitation is disregarded for purposes of determining withholding. Subsequent adjustment will be necessary where, for example, a producer or operator fails to furnish a timely certificate or revokes an erroneous certificate. The first purchaser must take account of each adjustment on his "windfall profit" tax return (Form 720 and Form 6047). An additional statement must be included with the return if the entire adjustment is not reported in the return for the taxable period giving rise to the adjustment.[164]

The temporary regulations require full withholding adjustments in subsequent payments to the same person (whether or not from the same property) so that the withholding will be corrected as soon as possible. However, in adjustments for underwithholding, no amount shall be deducted from crude oil payments in excess of the "windfall profit" attributable to the crude oil covered by the payment. Additionally, no withholding adjustments

---

[159]Prop. Reg. § 150.6050C-1(b).

[160]Prop. Reg. § 150.6050C-1.

[161]Prop. Reg. § 150.6050C-1(f).

[162]Prop. Reg. § 150.4995-2(c).

[163]For an analysis of "built-in over-withholding" as a result of this aspect of the tax, see R. Statham and K. Keenum, "WPT Tier 1 Crude Subject to Built-In Excess Withholding," 78 *Oil & Gas J.* 125 (October 20, 1980).

[164]Prop. Reg. § 150.4995-1(c).

may be made from payments for crude oil removed in a later calendar year or after the first purchaser has furnished his annual statement of "windfall profit" tax liability.[165] If the overwithholding or underwithholding has not been corrected before these dates, the producer must file an annual return where the amount withheld was insufficient or may file for a credit or refund where too much was withheld.

Under the interim regulations, if the operator has not furnished an operator's certificate or the first purchaser has reason to believe the certificate contains incorrect statements affecting computation of the tax, the first purchaser must withhold a maximum amount of tax, based on the classification of the oil under DOE price controls. Under these circumstances, no tax would be withheld on revenues for lower tier crude oil. The producer would withhold revenues from upper tier and uncontrolled crude oil based on the 70 percent maximum rate applied to the excess of the removal price over a base price of $11.01, adjusted for inflation and the severance tax adjustment, if known by the first purchaser.[166] These regulations governing inadequate operator's certificates apply to crude oil removed prior to October 1, 1980. A purchaser may continue to apply the interim rules until December 14, 1980, provided he makes subsequent withholding adjustments to conform the amount withheld to that required under the temporary regulations in effect after September 30, 1980. As is apparent from the rule, failure to furnish a valid operator's certificate may result in the withholding of substantially more than the tax owed.

Under the temporary regulations published on September 30, 1980, the failure to furnish a valid operator's certificate has somewhat less drastic effects. If the operator fails to state the tier of the oil or the purchaser has reason to believe the designation is incorrect, the oil is assumed to be Tier 1 production subject to a 70 percent rate.[167] If the adjusted base price is missing or believed incorrect, the adjusted base price is presumed under the regulations.[168] For Tier 1 oil, the base price is assumed to be $11.01 plus an amount equal to $11.01 multiplied by the quarterly inflation adjustment. For Tier 2 oil, the base price is assumed to be $12.11 plus an amount equal to $12.11 multiplied by the quarterly inflation adjustment. For Tier 3 oil, the base price is assumed to be $13.21 plus the amount equal to that figure multiplied by the quarterly inflation adjustment.[169] If the missing item is the

[165]Prop. Reg. § 150.4995-1(c)(ii).

[166]Prop. Reg. § 150.4995-1(b)(2). The temporary regulations provide an interim rule for withholding on payments made after April 18 and before June 4 on oil removed on or after March 1. At his option, the first purchaser could use either the general rule or the interim rule. Under the interim rule, the first purchaser would have withheld 70 percent of the excess (if any) of the purchase price per barrel over $11.22 ($11.47 for oil removed after March 31).

[167]Prop. Reg. § 150.4995-1(b)(2)(i)(A).

[168]A number of the comments filed with the IRS on the proposed regulations addressed the need to clarify when a first purchaser "has no reason to believe" that the information contained in a certification is incorrect. For example, the American Petroleum Institute ("API") recommended that for purposes of withholding only, the purchaser should be entitled to rely upon an operator certification signed under penalty of perjury. Comments of API, filed June 3, 1980, at 3; *see also* Comments of Pennzoil Producing Co., filed June 3, 1980, at 7-8; Comments of Basin, Inc., filed June 3, 1980, at 14-15, 19; Comments of Koch Oil Co., filed June 2, 1980, at 3, 13-16; M. Sanders, R. Sills, "Proposed Regs. Expand First Purchasers' Duties Beyond Windfall Profit Tax Act," *Journal of Taxation* 138, 139-40 (September 1980).

[169]Prop. Reg. § 150.4995-1(b)(2)(i)(B).

severance tax adjustment, the adjustment is assumed to be inapplicable unless the purchaser knows the amount.[170]

E. *Depositary Requirements*

The amounts withheld under the "windfall profit" tax must be deposited in a Federal Reserve Bank or authorized financial institution. The deposit requirements for integrated oil companies differ from those which apply to other first purchasers. For purposes of the depositary requirements, "independent refiners" are treated differently from "integrated oil companies."[171] If the first purchaser and the operator have elected to have the operator assume the obligation of withholding and depositing the tax, the operator will be treated as having the same status as the first purchaser, unless the operator is an integrated oil company.[172]

1. Deposit Requirements for Integrated Oil Companies

Integrated oil companies must make semi-monthly deposits of estimated tax based on the tax on oil removed during the semi-monthly period.[173] The two semi-monthly periods are the first 15 days of the calendar month and the remainder of the month.[174] Integrated oil companies must deposit the estimated tax by the ninth day of the semi-monthly period following the semi-monthly period in which the oil was removed.[175]

The temporary regulations contain provisions to determine whether an integrated oil company has complied with the depositary requirements for the estimated tax. Generally, these requirements are met if the company complies with any of the following four "safehaven" standards computed with regard to the net income limitation, if applicable:

(1)(a) The company's deposit for the semi-monthly period is at least 90 percent of the total deposit required for the period, *and*

(b) if the period occurs in a month other than the last month in a taxable period, it deposits any underpayment by the ninth day of the second month following that month; *or*

(2)(a) The company's deposit for each semi-monthly period in the month is not less than 45 percent of the total deposit required for the month, *and*

(b) if the month is other than the last month in the taxable period, it deposits any underpayment for the month by the ninth day of the second month following that month; *or*

(3)(a) Its deposit for each semi-monthly period in the month is not less than 50 percent of the total deposit required in the second preceding month (determined without regard to the "safehaven" standards) *and*

(b) if the month is other than the last month in a calendar quarter, it deposits any underpayment for the month by the ninth day of the second month following that month; *or*

---

[170] Prop. Reg. § 150.4995-1(b)(2)(i)(C).
[171] Prop. Reg. § 150.4995-3(a), (b).
[172] I.R.C. § 4995(a)(7).
[173] I.R.C. § 4995(b)(1).
[174] Prop. Reg. § 150.4995-3(a)(3)(i).
[175] Prop. Reg. § 150.4995-3(a)(3)(ii). For purposes of the depositary requirements for integrated oil companies, oil removed after February 29, 1980 and before April 4, 1980, is treated as having been removed on April 4.

(4)(a) The requirements of (1)(a), (2)(a), or 3(a) above are satisfied for the first semi-monthly period, *and*

(b) the company's deposit for the second semi-monthly period when added to the deposit for the first semi-monthly period is at least 90 percent of the deposit required for the month, *and*

(c) if the period occurs in a month other than the last month in a calendar quarter, the company deposits any underpayment by the ninth day of the second month following that month.

The compliance standards set forth in (2) and (3) above, do not apply to companies which normally incur 75 percent or more of their monthly depositary liability in the first semi-monthly period. Where the aggregate amount of deposit liability for a taxable period exceeds the amount deposited for that period, the company must deposit the difference by the last day of the first month following the close of the taxable period.[176]

2. Deposit Requirements for Other Producers and Purchasers

In general, persons other than integrated oil companies must make deposits for each calendar month no later than 45 days after the close of the month. The amount deposited will be the tax required to be withheld from payments that have been or will be made for crude oil required to be removed during the month.[177]

"Independent refiners" purchasing crude oil under a delayed payment contract follow a different rule if no payment is required to be made to the purchaser before the forty-sixth day after the close of the month in which the oil is purchased. Under these circumstances, the monthly deposit of the tax on the oil must be made no later than the last day of the second month which begins after the month in which the oil was removed.[178] An "independent refiner" is one who, in the second preceding calendar quarter, (1) obtained more than 70 percent of his refinery input of domestic (or domestic and imported oil) from producers not controlled by the refiner and (2) marketed during the second preceding calendar quarter and continues to market gasoline through branded or non-branded independent marketers.[179]

Producers of oil not subject to withholding (except integrated oil companies) must make monthly deposits not later than 45 days after the crude oil was removed or deemed to have been removed from the premises. A producer will have met this requirement if his aggregate deposit liability for

[176]Prop. Reg. § 150.4995-3(a).

The temporary regulations contain a special rule that applies if the net income limitation is taken into account by a producer who deposits his own tax. *See* 45 Fed. Reg. at 73468. If his deposits for a taxable period exceed the amount of the tax computed with regard to the estimated effect of the net income limitation, but not the amount computed without regard to the net income limitation, he may not claim a credit or refund until the end of his taxable year (for federal income tax) with respect to which the limitation is computed. However, the excess of a producer's deposits for a semi-monthly period over the amount of the tax for that period (computed with regard to the estimated effect of the net income limitation) can be applied in order of time to each of the producer's subsequent semi-monthly periods until the excess is exhausted. Prop. Reg. § 150.4995-3(g). Amounts for which a producer files a claim for a credit or refund may not be carried forward. Also, a producer may not carry forward any excess deposit into a subsequent semi-monthly period which occurs in a taxable period beginning in a different income tax year. *Id.*

[177]Prop. Reg. § 150.4995-3(c).

[178]Prop. Reg. § 150.4993-3(b).

[179]Prop. Reg. § 150.4996-1(h).

the three months of a taxable period is less than $100 and the producer either deposits the amount of the tax by the last day for filing his tax return for the quarter or remits the amount of the tax with his return. Otherwise, the producer must comply with the depositary requirement by meeting any of the following "safehaven" provisions, computed with regard to the net income limitation, if applicable, and by depositing no later than 45 days after the close of the taxable period any additional amounts required to be deposited:

(1) the producer's deposit for the month is not less than 90 percent of the required amount; or

(2) the producer's deposit for each month of the taxable period is not less than 30 percent of the total amount required to be deposited for the three months of the taxable period; or

(3) the producer's deposit for the month is not less than 100 percent of the amount required for the third preceding month (determined without regard to (2) and (3) above).

The compliance standards in (2) and (3) above do not apply to any producer who normally incurs more than 45 percent of its total deposit liability for a taxable period in the first month of the period.[180]

F. *Tax Returns*

The statute and the temporary regulations do not require a producer to file a "windfall profit" tax return if the first purchaser withheld the proper amount of tax from crude oil revenues. It is likely that many producers will file returns due to improper withholding not corrected by adjustments during the calendar year.

A quarterly return must be filed by (1) first purchasers who deduct and withhold tax; (2) operators who deduct and withhold the tax pursuant to a joint election with the first purchaser, (3) producers of crude oil which is not subject to withholding, and (4) every producer who takes the net income limitation into account in making "windfall profit" tax deposits.[181] Quarterly returns are due on the last day of the second month following the close of the last month in the quarter.[182] An annual return must be filed by each producer whose liability for tax on oil removed during the calendar year exceeds the amounts withheld. Annual returns are due on the last day of February following the calendar year for which the return is filed.[183]

The quarterly "windfall profit" tax return will consist of Form 720 (Quarterly Federal Excise Tax Return) with Form 6047 attached. Form 6047, recently published by the IRS, requires the reporting of the quantities of crude oil produced in each of the various taxable and exempt categories. Within each category, the first purchaser is required to report on an aggre-

[180] Prop. Reg. § 150.4995-3(f). The provisions of Prop. Reg. § 150.4995-3(g) for reduction of future deposits where the operation of the net income limitation is taken into account and deposits exceed liability also apply where producers deposit their own tax under Prop. Reg. § 150.4995-3 (f). In this circumstance, the special rule, discussed above, is applied on a monthly, rather than a semi-monthly basis. *See* Prop. Reg. § 150.4995-3(g), discussed in Note 176, *supra*.

[181] Prop. Reg. § 150.4997-1(a)(1).

[182] Prop. Reg. § 150.6076-1.

[183] *Id.*

amounts in contest, file a claim for a refund, and then sue for the refund in the Court of Claims or the appropriate United States District Court.[195]

After the taxpayer receives a notice of deficiency from the IRS, he has 90 days (150 days if notice is addressed to one outside the United States) in which to appeal to the Tax Court.[196] If the taxpayer loses before the Tax Court, he may appeal to the United States Court of Appeals.[197]

If the taxpayer has overpaid the tax, he must file a claim for a refund or credit for overpayment of tax within 3 years from the time that the return was filed or two years from the time the tax was paid, whichever expires later.[198] He may enforce that claim in the Court of Claims.[199] A Court of Claims decision may be reviewed only in the Supreme Court, and, generally, only by writ of certiorari.[200] Alternatively, the taxpayer may seek to enforce his claim in United States District Court.[201] The district court's decision may be appealed to the United States Court of Appeals[202] and reviewed by the Supreme Court by writ of certiorari.[203]

IV. Conclusion

The "windfall profit" tax scheme is still in a state of rapid change.[204] The retroactive effective date of the statute necessitated rapid action by the IRS to draft and issue interim rules. As public comments in the IRS's several rulemakings have pointed out, the Interim Regulations—necessarily drafted in haste—do not address many substantial ambiguities in the statutory scheme. The statutory incorporation of the complex DOE price control program further complicates the legal and administrative issues facing the IRS.

As the IRS attempts to mesh its interim and final regulations with the regular business practices in the petroleum industry, substantial changes can be expected. As of the date of this article, November 14, 1980, the IRS still has under consideration the promulgation of final regulations for administration of the tax, establishment of Tier 2 and Tier 3 base prices, and withholding and deposits. No interim or proposed regulations have been issued further defining the treatment of exempt front end oil.

In light of the prospects for immediate changes in the taxing scheme, producers, purchasers, and others who are affected by the tax should be alert to the potential problems, as well as planning opportunities, which may arise in the near future. Advice on compliance and planning necessarily must take into account individual circumstances. At the present stage of the development of the "windfall profit" tax scheme, any comment on the tax thus may have a short useful life. The purpose of this article is to provide a roadmap through the existing interim regulations and a foundation for interpreting new developments.

---

[195]*Id.*, § 58A.03.
[196]*Id.*, § 50.35.
[197]*Id.*, § 51.03.
[198]*Id.*, § 58.25.
[199]*Id.*, § 58A.19.
[200]*Id.*, § 58A.39.
[201]*Id.*, § 58A.18.
[202]*Id.*, § 58A.38.
[203]*Id.*, § 58A.39.
[204]As of the date of this article, a suit challenging the constitutionality of the "windfall profit" tax reportedly had been filed in federal district court in Cheyenne, Wyoming, by the Independent Petroleum Association of America. Independent Petroleum Ass'n of America v. United States, No. C80-0302, (D.Wyo., filed October 14, 1980). The complaint alleges that the tax violates article I, section 8, clause 1 of the Constitution because the tax is not levied uniformly throughout the United States (certain Alaskan oil is excluded) and also challenges the tax as violating the due process and just compensation clauses of the fifth amendment. Another challenge to the Act had been filed in federal district court in Oklahoma by the Oklahoma Energy Producers, a trade association. *See* "IPAA-Led Group Files Windfall Profit Tax Suit," 78 *Oil & Gas J.* 104 (October 20, 1980).