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Oil Industry Taxes: A Cash Cow For Government

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Introduction

The tragic impact of the British Petroleum oil spill on the five U.S. states that border the Gulf of Mexico has prompted calls for higher taxes on U.S.-based oil and gas companies even though the industry's tax remittances already exceed its corporate profits.

Some legislators would prefer an economy-wide tax on fossil fuel energy, either a carbon tax or cap-and-trade system. Others prefer a targeted approach that aims to repeal any tax provision that benefits the oil and gas industry. Champions of this approach even include on their hit lists tax provisions that benefit many other industries, in which case they propose withdrawing the benefit just for the oil and gas industry.

A common theme to both approaches is a bald assertion that the oil and gas industry pays little in tax. Despite the hyperbolic rhetoric from some lawmakers and interest groups, the facts do not support a claim that the oil and gas industry in America is under-taxed. Hard data from the Energy Information

Key Findings

- *Data from the Energy Information Administration show that governments in the U.S. and abroad are hugely dependent upon the direct and indirect taxes paid by the largest consolidated oil companies, and that between 1981 and 2008 these tax payments exceeded corporate profits by 40 percent.*
- *Between 1981 and 2008, the oil industry paid more than $388 billion to the federal and state governments in corporate income taxes, but they paid almost twice that amount, $683 billion, to foreign governments.*
- *Profits and income tax payments mirror the price of oil. In 1998 when the price was low, the industry paid just $733 million in federal and state income taxes. In 2006, with the real price of oil averaging over $63 per barrel, the industry paid a record $37 billion in corporate income taxes.*
- *Excise tax collections have grown steadily. Between 1981 and 2008, $1.1 trillion was collected in excise and sales taxes on petroleum products. In 1999 governments collected $59 billion, more than twice the industry's net profits that year.*
- *In severance, property and so-called windfall profit taxes, the industry paid more than $472 billion between 1981 and 2008.*

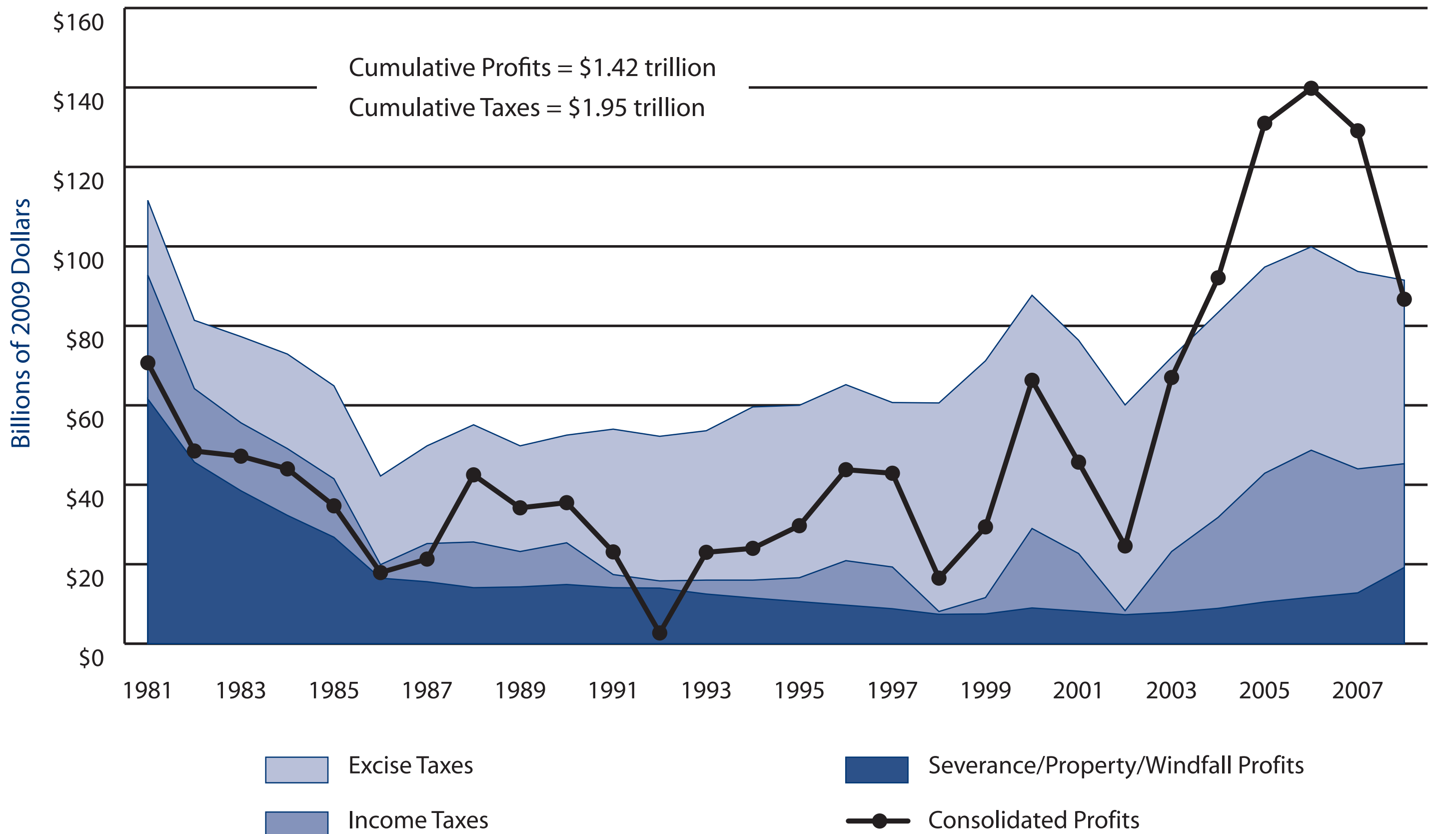
Administration show that governments in the U.S. (and even those abroad) are hugely dependent upon the direct and indirect taxes paid by the largest consolidated oil companies.[1]

Indeed, since 1981, when the failed windfall profits tax was first enacted, federal, state, and local governments in the U.S. have collected more in taxes from the oil industry than the industry has earned in actual profits for its shareholders.[2] For example, after adjusting for inflation, the combined net earnings (net of taxes and expenses) for the largest petroleum companies between 1981 and 2008 totaled $1.4 trillion. By contrast, the total amount of taxes collected by U.S. governments from the oil companies topped $1.95 trillion, roughly 40 percent more than the industry's combined profits. Tax collections exceeded company profits in 23 of the 27 years surveyed.

As Figure 1 shows, industry profits have varied wildly since 1981 and largely mirror the highly volatile price of oil. Indeed, the profits earned in 1981 turned out to be a high-water mark that the industry would not top until 2004. The chart also shows that the record profits earned in 2005, 2006 and 2007 were an aberration, not a trend. Remarkably, nearly 30 percent of the total profits earned by the industry between 1981 and 2008 were earned in those three years alone.

Figure 1

Since 1981, Taxes Collected from Oil Industry Have Exceeded Company Profits by Nearly 40 Percent



Source: Energy Information Administration

1 For a list of the major oil companies analyzed see: http://www.eia.doe.gov/emeu/perfpro/CoList.html

2 1981 is the earliest year in which full data are available for every type of tax collected. Data for excise and severance taxes are not available before 1981. ftp://ftp.eia.doe.gov/pub/energy.overview/frs/s5112.xls

Figure 2 shows the wide fluctuations in the price of imported crude oil in both nominal and real terms. Starting at the nearly $100 per barrel highpoint in 1981, the price of a barrel of oil fell gradually until it hit bottom at $21 per barrel in July 1986. It held mostly steady until about 2005 when it rocketed to a record high during the summer of 2008. Since then, the price of crude has fallen to more moderate levels.

Corporate Income Taxes

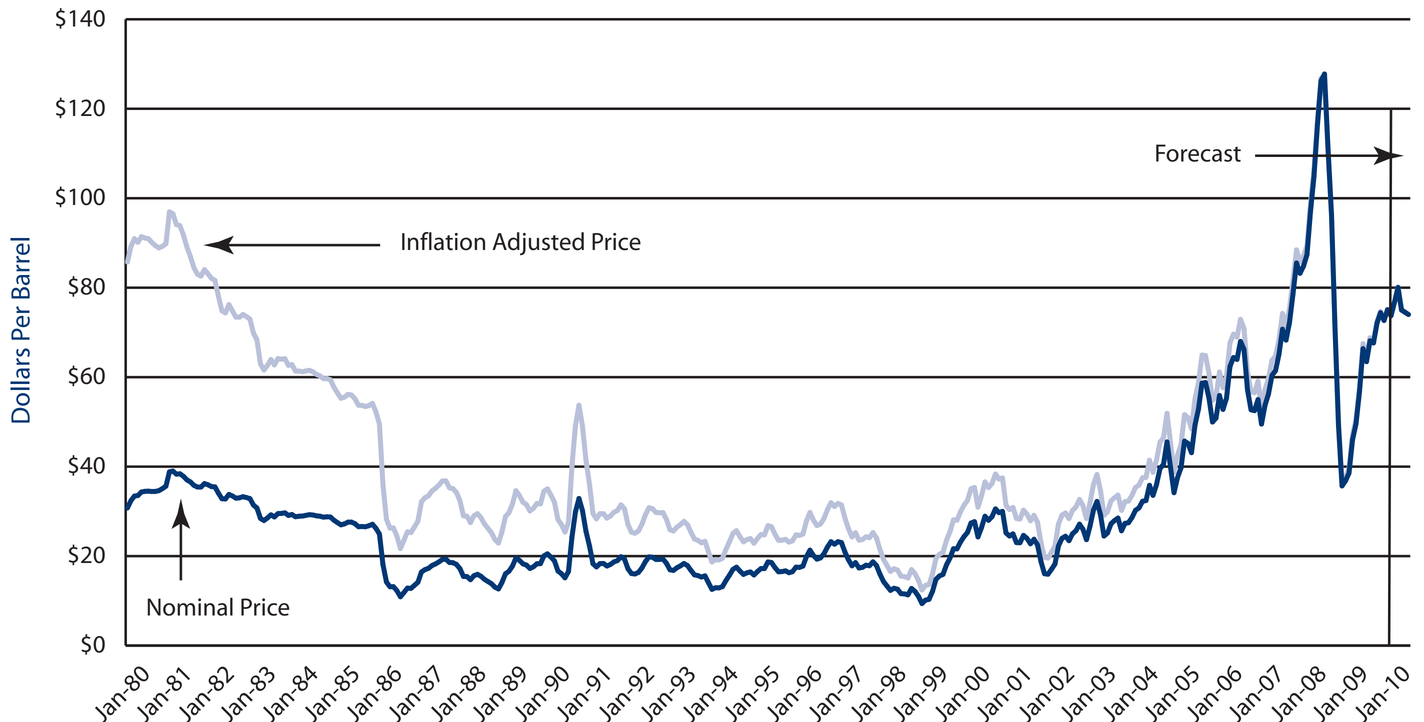
Not surprisingly, the corporate income taxes paid to the federal government and to state governments were as volatile as the industry's profits. As Table 1 indicates, between 1981 and 2008, the oil industry paid more than $388 billion to the federal and state governments in corporate income taxes. (As will be discussed below, the industry paid almost twice that amount, $683 billion, in income taxes to foreign governments during the same period).

The low mark in income tax collections was 1998, where the industry paid a total of $733 million in federal and state income taxes while the average price of imported oil hovered around $16 per barrel, adjusting for inflation.[3] By contrast, the industry paid a record $37 billion in corporate income taxes in 2006 while the price of imported oil averaged over $63 per barrel, adjusting for inflation.

Despite the fact that corporate income tax rates have been falling across the globe over the past 20 years, corporate income tax expenses still consume a large share of the industry's pre-tax income. Figure 3 plots the annual share of industry pre-tax profits that go to income taxes to all countries. During the early 1980s, income tax expenses routinely accounted for more than 50 percent of the industry's pre-tax

Figure 2

Imported Crude Oil Prices: Nominal and Inflation Adjusted



Source: Energy Information Administration, Short-term Energy Outlook, July 2010

3 http://www.eia.doe.gov/emeu/steo/pub/fsheets/real_prices.html

profits. In 1986, the U.S. cut its corporate income tax rate to 34 percent from 46 percent and set off a two-decade decline in worldwide corporate income tax rates. Since then, income taxes as a share of pre-tax profits have hovered around 40 percent for the major oil companies. This is likely much higher than most industries because oil companies tend to do the majority of their business in countries – such as Norway, Saudi Arabia, and Nigeria – that levy much higher taxes on petroleum firms than on other corporations.

Excise Taxes

In contrast to the volatile price of oil and corporate profits, excise tax collections have grown fairly steadily over the past two and a half decades. That is because gasoline excise taxes are levied on a per-gallon basis rather than on the price of gasoline. So as Americans consume more gasoline, governments collect more in excise taxes.

Today, U.S. consumers pay an average of 47 cents per gallon in gasoline taxes (see Figure 4). The federal gasoline excise tax is 18.4 cents per gallon while the average state and local tax is 28.6 cents. The vast majority of these taxes are levied at a flat rate per gallon—regardless of whether a gallon of gas costs $1.49, $2.49, or $3.49. Thus, the effective rate of these taxes can vary wildly. When gasoline sold for $1 per

Table 1

Oil Industry Profits Versus Taxes Paid and Remitted
Millions of Constant 2009 Dollars

Year	Consolidated Oil Industry Net Income	Total Income Taxes Paid	Excise Taxes Remitted	Severance/ Property/ Windfall Profits Taxes Paid	Total U.S. Domestic Taxes Paid and Remitted	Total Foreign Income Taxes Paid
1981	$70,717	$31,161	$18,768	$61,607	$111,536	$36,206
1982	$48,511	$18,543	$17,240	$45,697	$81,479	$29,154
1983	$47,203	$17,053	$21,664	$38,451	$77,169	$34,116
1984	$44,000	$16,779	$23,754	$32,339	$72,873	$35,531
1985	$34,652	$14,678	$23,433	$26,808	$64,920	$32,846
1986	$17,943	$3,396	$22,322	$16,502	$42,220	$14,876
1987	$21,259	$9,632	$24,591	$15,626	$49,848	$16,130
1988	$42,525	$11,547	$29,538	$14,104	$55,188	$12,433
1989	$34,229	$8,945	$26,589	$14,315	$49,849	$13,289
1990	$35,468	$10,454	$27,076	$14,858	$52,388	$16,920
1991	$23,122	$3,276	$36,627	$14,137	$54,041	$12,771
1992	$2,687	$1,809	$36,366	$13,996	$52,171	$12,245
1993	$22,995	$3,483	$37,588	$12,503	$53,573	$10,795
1994	$23,954	$4,524	$43,562	$11,535	$59,620	$10,880
1995	$29,747	$5,960	$43,376	$10,634	$59,970	$11,276
1996	$43,795	$11,218	$44,338	$9,671	$65,227	$14,785
1997	$42,883	$10,472	$41,416	$8,823	$60,711	$13,670
1998	$16,477	$733	$52,539	$7,450	$60,722	$6,407
1999	$29,445	$4,068	$59,613	$7,501	$71,182	$11,107
2000	$66,270	$19,952	$58,660	$8,953	$87,565	$22,273
2001	$45,712	$14,463	$53,677	$8,165	$76,304	$18,194
2002	$24,557	$1,011	$51,832	$7,341	$60,185	$16,499
2003	$66,958	$15,321	$48,862	$7,945	$72,128	$21,315
2004	$92,092	$22,934	$51,568	$8,935	$83,437	$30,923
2005	$130,961	$32,375	$51,857	$10,523	$94,754	$43,139
2006	$139,806	$37,012	$51,200	$11,661	$99,874	$56,864
2007	$129,100	$31,270	$49,716	$12,842	$93,828	$56,515
2008	$86,603	$26,077	$46,224	$19,218	$91,519	$72,133
Total	$1,413,669	$388,145	$1,093,995	$472,139	$1,954,280	$683,295

Source: Energy Information Administration

gallon in the 1990s, about half the price was taxes, but when gas reached $4 per gallon in 2008, only about 12 percent of the price was taxes.[4]

Ten states also apply their state sales tax or gross receipts tax on gasoline sales and these collections are linked to the price of a gallon of gas. As the price goes up, the state profits even more from each gallon sold.

Between 1981 and 2008, the federal, state, and local governments collected nearly $1.1 trillion in excise and sales taxes on petroleum products after adjusting for inflation. In 12 of those years, governments actually collected more in excise taxes alone than the industry earned in total profits. The highpoint in excise tax collections was 1999 when all U.S. governments reaped more than $59 billion – which happened to be more than twice the industry net profits that year.

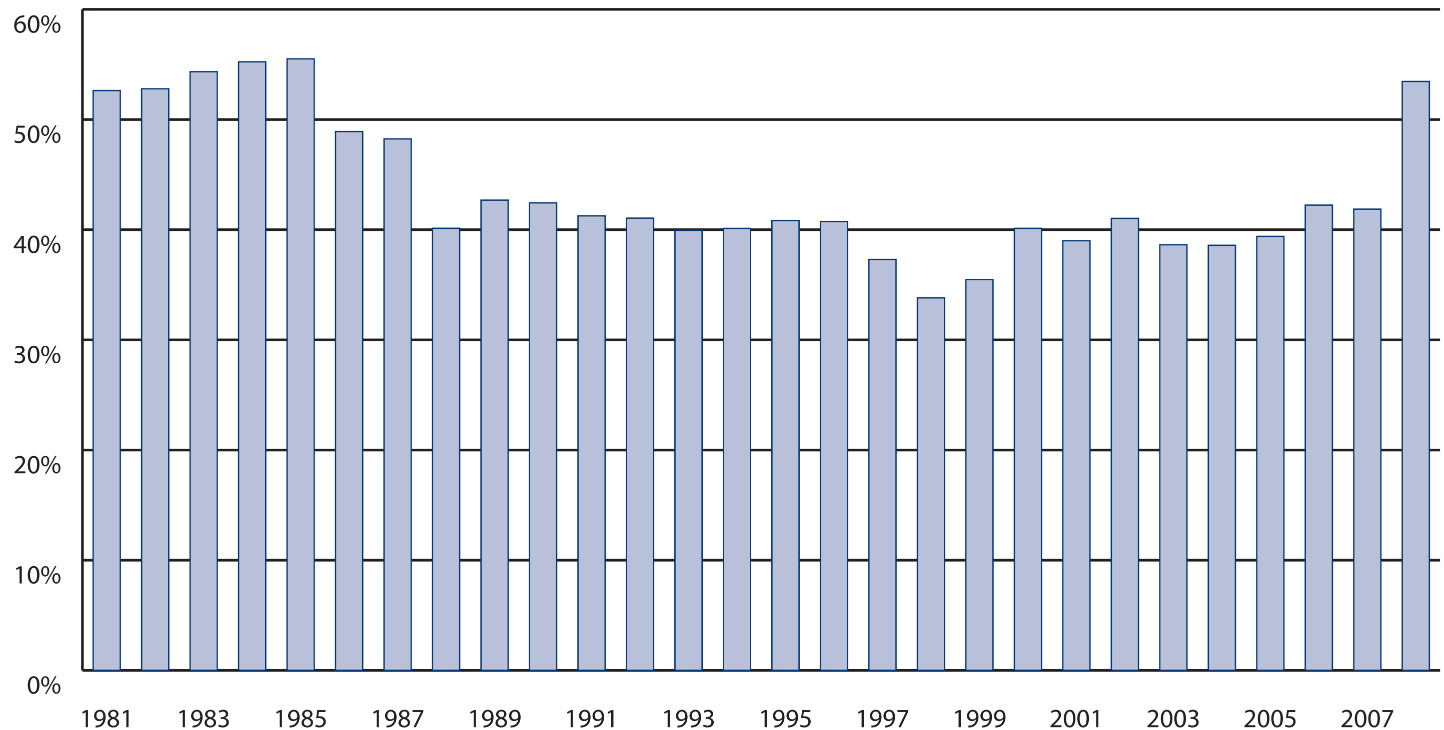
Severance, Property, and Windfall Profits Taxes

The last basket of domestic taxes paid by the oil industry includes severance taxes, property taxes, and the short-lived windfall profits tax.[5] All told, these taxes totaled more than $472 billion between 1981 and 2008. Severance taxes, which are the fees oil companies pay to governments for the right to extract oil from public lands and waters, totaled more than $113 billion, after adjusting for inflation, during this period.

For some states, severance tax revenues are so substantial that they are able to fund their government services without levying one

Figure 3

Total Income Tax Expenses as a Share of Pre-Tax Consolidated Industry Income



Source: Energy Information Administration

4 http://api.org/statistics/fueltaxes/upload/July_2010_Gasoline_and_Diesel_Summary.pdf

5 Although all companies remit payroll taxes on behalf of their employees, these are not included in this discussion. Of course, economists all agree that to some extent corporate taxes are ultimately paid by either consumers through higher prices, workers through lower wages, or shareholders through lower dividends.

or more of the other major taxes, such as a personal or corporate income tax, or sales tax. Alaska's severance tax fortunes are well known. Alaska does not levy a general sales tax or a personal income tax, but every year the state distributes thousands of dollars to every citizen out of the severance tax revenues collected in the Alaska Permanent Fund.

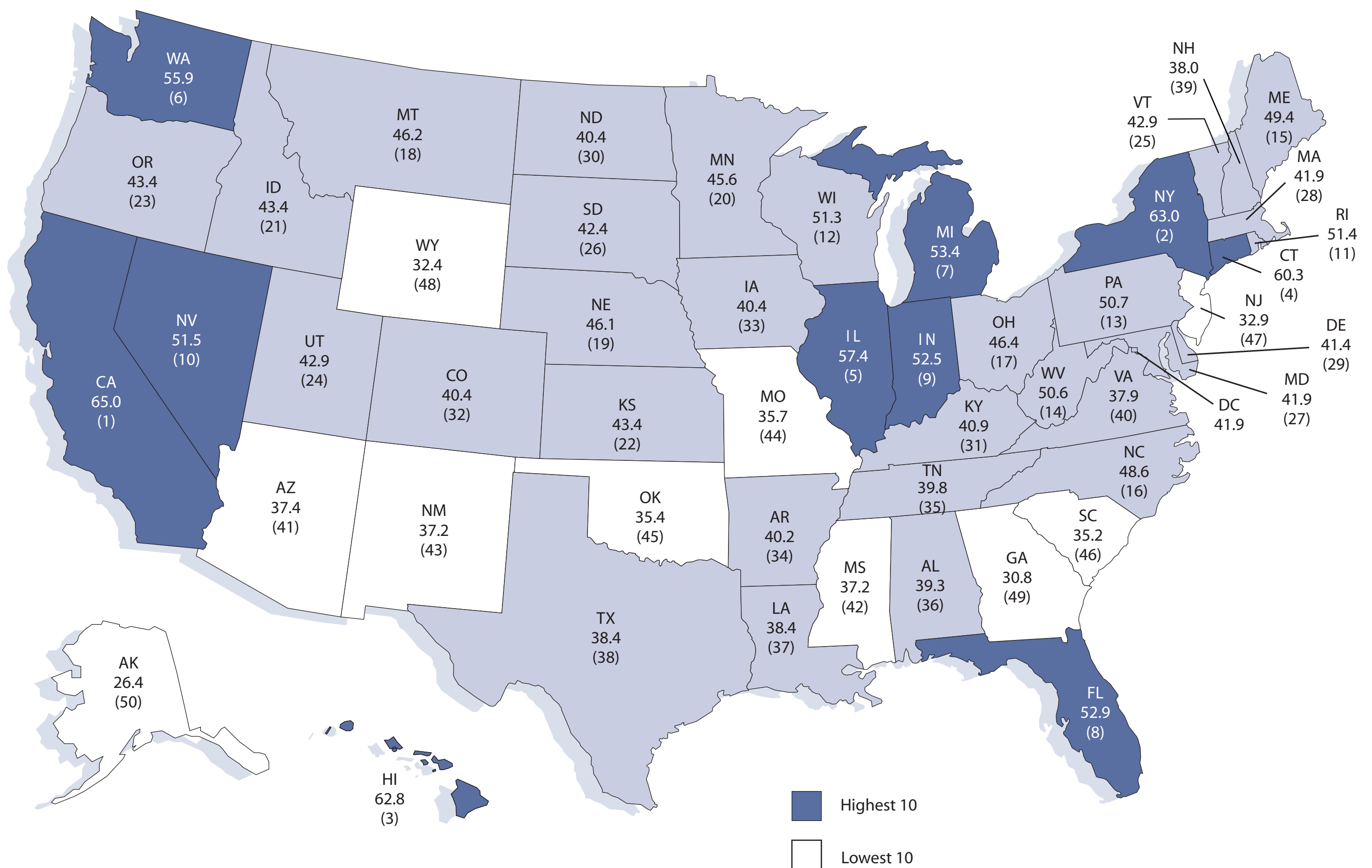
The Failed Windfall Profits Tax Experiment

During the 1980s the federal government experimented with a new tax intended to limit the "windfall profits" of domestic oil companies. In reaction to the rise of energy prices during the late 1970s and the removal of price controls on the energy industry, President Jimmy Carter signed the Crude Oil Windfall Profits Tax Act into effect on April 2, 1980.[6]

The tax was technically misnamed because it was in fact an excise tax, not a "profits" tax. The tax was imposed on the difference between the market price of oil and a government-determined base price. For example, a 70 percent tax was levied on the difference between the market price received by oil companies and the average base price of $12.81 per barrel. Independent

Figure 4

Gas Tax Rates (Cents Per Gallon)



Source: Tax Foundation calculations based on data from the Energy Information Administration and the American Petroleum Institute. Where general sales taxes or gross receipts taxes apply—California, Connecticut, Georgia, Hawaii, Illinois, Indiana, Iowa, Michigan, New Jersey and New York—an excise equivalent has been calculated.

6 Salvatore Lazzari, "The Windfall Profit Tax On Crude Oil: Overview of the Issues," CRS Report for Congress, Congressional Research Service (September 12, 1990), p. 3.

producers, stripper wells and heavy oils were taxed at different rates.

The windfall profits tax was forecasted to raise more than $320 billion between 1980 and 1989. However, according to the Congressional Research Service (CRS), the government collected only $80 billion in gross tax revenue ($146 billion in 2004 dollars). The net amount was actually less than this—roughly $40 billion—because the tax was deductible against corporate income.

CRS also found the windfall profits tax had the effect of decreasing domestic production by 3 percent to 6 percent, thereby increasing American dependence on foreign oil sources by 8 percent to 16 percent. A side effect was declining, not increasing, income tax collections. Figure 1 clearly shows that while the tax raised considerable revenue in 1981, those revenues declined to almost nothing as the domestic industry collapsed.

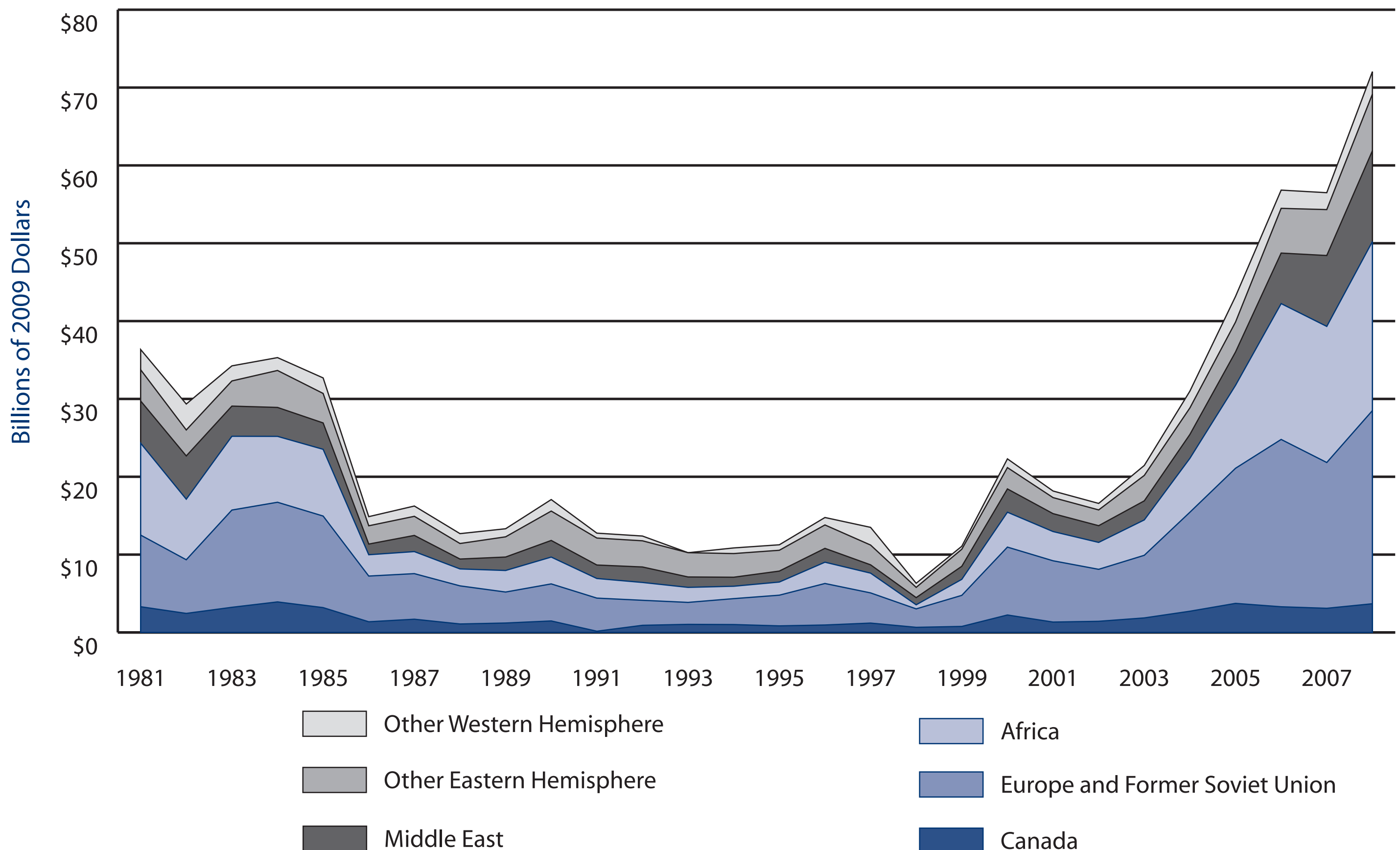
Taxes Paid to Foreign Governments

EIA data indicate that foreign governments have become as addicted to tax revenues from the oil industry as have U.S. governments. After adjusting for inflation, the major oil companies paid a cumulative $683 billion in income taxes to foreign governments between 1981 and 2008.

Figure 5 shows the composition of these tax payments to governments in different regions of the globe. In recent years, the largest

Figure 5

Foreign Income Taxes Paid by Oil Industry: 1981 to 2008



Source: Energy Information Administration

share of foreign income taxes paid by the oil companies has been to Europe and the former Soviet Union. Indeed, oil companies paid more than $103 billion in income taxes to these countries between 2003 and 2008 alone. African countries collected $79 billion during the same period, the second-largest share of income taxes to foreign governments, while Middle-Eastern countries ranked third at $37 billion.

The foreign tax credit is an essential feature of all worldwide income tax codes, and an inexcusable double-taxation would occur if it were repealed or curtailed for the oil and gas industry, as the Obama Administration and some in Congress have suggested.

Many oil-rich nations impose very high taxes on U.S.-based oil companies. Norway, like Alaska, is very dependent upon oil revenues to fund government. Indeed, by one account, revenues from oil extraction account for 30 percent of the country's GDP.[7] Norway subjects oil companies to both the general corporate tax rate of 28 percent and an additional special tax of 50 percent.[8] In Saudi Arabia, the standard corporate income tax rate is 20 percent but the tax rate for companies engaged in oil production is 85 percent.[9] These high tax payments abroad translate into high foreign tax credits on U.S. tax returns, dampening collections domestically.

It is universally accepted that two countries should not both tax the same dollar of income, so countries have enacted various tax laws to protect individuals and companies from double taxation. The U.S. worldwide tax system requires any company or individual who earns income abroad to report it on their U.S. tax returns but allows taxpayers to subtract what they paid abroad from what they owe the U.S. This is the foreign tax credit, and the rule applies to every American company or individual who pays earns income pays taxes abroad. It is an essential feature of all worldwide income tax codes, and an inexcusable double-taxation would occur if it were repealed or curtailed for the oil and gas industry, as the Obama Administration and some in Congress have suggested.

Conclusion

Major news events such as the Gulf oil spill and $4 per gallon gasoline tend to bring out the most extreme rhetoric about oil company profits and the taxes they pay. Indeed, the major U.S. oil companies are among the largest taxpayers in the country, both in terms of their direct income tax payments and in terms of how much indirect tax they remit to federal, state, and local governments.

Hard data from the Energy Information Administration shows that the federal, state, and local governments in the U.S. collected more in taxes from the oil industry between 1981 and 2008 than the industry earned in profits for their shareholders. In most years, the amount of excise taxes the companies remitted alone exceeded their net profits.

The bottom line is that governments are as addicted to the taxes generated from the oil industry as are American consumers to oil industry products. If politicians and interest groups believe the industry should pay higher taxes, they should be honest about it and not mislead the public about the industry's contributions to public coffers.

7 http://www.norway.org.uk/ARKIV/Other/Current-Affairs/business/news/norwayahavenforoilproduction/

8 http://public.deloitte.no/dokumenter/Perspective_on_norwegian_oil_gas_taxation.pdf

9 http://www.pkf.com/site/webdav/site/pkf/shared/Intranet/International%20Tax%20other%20attachments/Country%20Tax%20Guides%20in%20PDF/Saudi%20Arabia%20Tax%20Guide%202009.pdf

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