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NEWS ANALYSIS

Whither Windfall Profits Taxes?

by Lee A. Sheppard

Let them drive electric cars.

Say what you will about the Dingell dynasty, its members at least represented the genuine economic interests of their Michigan constituents. Not so the current Democratic senator, Debbie Stabenow.

Stabenow's Marie Antoinette moment came in a June 7 Senate hearing when she cheerfully announced that she personally didn't care about gasoline prices because she'd driven her new electric car from Michigan to Washington, bypassing all the service stations.

"On the issue of gas prices, after waiting for a long time to have enough chips in this country to finally get my electric vehicle, I got it and drove it from Michigan to here this last weekend and went by every single gas station and it didn't matter how high it was," she said. "I'm looking forward to the opportunity for us to move to vehicles that aren't going to be dependent on the whims of the oil companies and the international markets."

Doubtless she thought she was being virtuous rather than out of touch. Her senatorial paycheck is three times the average salary of her constituents. Indeed, the cheapest electric car costs a mere $3,000 less than the average salary of those constituents. The third-term senator is a member of leadership — chair of the Senate Democratic Policy and Communications Committee — and will be up for reelection in 2024.

Stabenow must have had a better time than an intrepid *Wall Street Journal* reporter and her friend who took a Kia EV6 on a four-day road trip from New Orleans to Chicago and back, armed with an app map of charging stations. Turns out quick-charge stations are mostly located at dealerships and are slower than advertised. The travelers spent $175 on charging; gas would have been $275 for the trip. They nearly ran out of battery power on several occasions, while the car's dashboard flashed a turtle symbol when power was low. Gasoline "fumes never smelled so sweet," the author concluded her cautionary tale (*The Wall Street Journal*, June 3, 2022).

Yes, it's summer driving season, and yes, oil and natural gas prices tick up seasonally. Democrats refuse to understand that living, breathing voters have rejected many of their grand schemes. Like the Obama administration, the Biden administration believes that unpopular policies just need to be explained better.

Ordinary people who depend on car transportation are being asked to believe that $5 gasoline ($6 diesel) is short-term pain for long-term gain. They're not buying it. The diesel price is important to the already stressed supply chain because many independent truckers can't afford to fill their 300-gallon tanks with $6 diesel fuel ($1,800 or more coming out of California, where produce comes from). Farmers also use diesel fuel for their equipment.

But Ukraine! That's a factor but far from the largest determinant of increased gasoline prices, which already nearly doubled a year ago. The conflict magnified what was already in process. Ukraine is a bigger factor in the increase in natural gas prices. Some 75 percent of U.S. liquefied natural gas is being exported to Europe.

This is controlled demolition, and it was on the label on the tin. The environmental plan President Biden ran on was extremely ambitious, including such impossibilities as a border carbon adjustment for imports from polluting countries.

"Number one: No more subsidies for the fossil fuel industry, no more drilling on federal lands, no more drilling, including offshore. No ability for the oil industry to continue to drill. Period. Ends," then-candidate Joe Biden said at a March 15, 2020, presidential debate. At a rare campaign appearance, he even personally promised an anxious teenager that there would be no more fossil fuels. Most observers might have interpreted these statements as campaign rhetoric.

On his first day in office, Biden revoked the permit for the Keystone pipeline, which would

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Will my rebate cover this? (Frank Molter/dpa/picture-alliance/Newscom)

have brought in nearly 1 million barrels per day fracked from Canadian tar sands. He signed executive orders telling the Department of the Interior to stop new leases on federal lands. Even when leases are in place, permits can be hamstrung by environmental and endangered-species challenges. Bank regulators and ESG requirements have discouraged new investment in oil projects.

"An incredible transition is taking place," Biden said the other day while trying to defend his administration's policies. Uh-huh. We're in the midst of a transition from dense, predictable, efficient fuels to intermittent, uncontrollable, medieval energy sources like windmills.

"Exxon made more money than God last year!" Biden said, blaming oil companies for not drilling and paying insufficient taxes. This is regarded as a preview of a party strategy to blame oil sellers for gasoline prices ahead of the midterm elections.

The White House sent a letter to the seven largest oil producers and refiners, threatening to invoke emergency powers to boost refinery output. "I understand that many factors contributed to the business decisions to reduce refinery capacity, which occurred before I took office. But at a time of war, refinery profit margins well above normal being passed directly onto American families are not acceptable," the letter stated.

And then there was a threat. "My administration is prepared to use all reasonable and appropriate federal government tools and emergency authorities to increase refinery capacity and output in the near term, and to ensure that every region of this country is appropriately supplied."

The American Petroleum Institute had earlier asked for some administration policies to be reversed. The oil companies asked to be allowed to drill on the outer continental shelf, revise the National Environmental Policy Act permit process, and urge the Federal Energy Regulatory Commission to permit more natural gas projects. They asked for little moves, such as the SEC reversing its climate disclosure proposal and the extension of carbon capture credits (section 45Q). Weirdly, they wanted to be able to export even more liquefied natural gas.

As this article was being written, Senate Finance Committee Chair Ron Wyden, D-Ore., was contemplating introduction of a 21 percent surtax on oil company profits exceeding 10 percent, effectively doubling those companies' corporate rate. Excess profits would be determined by subtracting a normal return of 10 percent on associated capital from current profits (CNN, June 15, 2022). He may have been inspired by a recent report from the Center for American Progress (CAP, discussed below).

> ***Does a windfall profits tax serve any purpose? Imposing a tax and then rebating it to consumers achieves no environmental aims.***

"The proposal I'm developing would help reverse perverse incentives to price gouge, by doubling the corporate tax rate on companies' excess profits, eliminating egregious buybacks and reducing accounting tricks," said Wyden. He would combine this surtax with a 25 percent tax on share buybacks (Bloomberg, June 14, 2022).

What's the point of a windfall profits tax, other than revenge against a Republican constituency? Does it serve any purpose? The bills before Congress aim to rebate the proceeds of a WPT to gasoline consumers. But imposing a tax and then rebating it to consumers doesn't achieve environmental aims.

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The Biden administration seems to have a vendetta against domestic producers that might give money to Republicans (the biggest oil companies give to both sides). Oh, but if Congress enacts a WPT, the Republicans would just reverse it if they regain control! True. The controlled opposition can be counted on to cut taxes and defend oil company interests.

Background

We've been around this block before.

The WPT was enacted as a successor to price controls that ended in 1980. It was considered a less disruptive alternative. Around here we talk a lot about the tripling of the oil price in 1973, which was a watershed. But the Iranian revolution of 1979 was another price increase. A nervous Congress — which had a better appreciation of our reliance on cheap fuel than it does now — put on price controls that were in effect during Republican and Democratic administrations.

The WPT that was in effect from 1980 to 1988 was an excise tax system reaching the excess of the market price over a baseline price determined quarterly. It applied to all sizes of producers. Rates were higher for larger, integrated producers, and the tax was limited to 90 percent of the net income from the same oil. As an excise, it was deductible for determining corporate income taxes (former sections 4991 through 4994).

The WPT applied only to domestically produced oil, so it discouraged domestic production. Domestic production was reduced, and imports increased. Three tiers of tax classification — two of which were exempt — carried over from the price controls. One-third of all domestically produced oil was exempt. The WPT was collected on the first sale — usually producer to refiner, which had to withhold. The WPT didn't produce the expected revenue and was repealed when oil prices fell.

Independent gasoline stations selling unbranded gasoline take excess production from majors. But the WPT enabled the latter to break their contracts with the former, depriving them of supply. So the independents complained to Congress that the majors were holding back. Congress responded with an allocation program. The WPT was amended regularly. When at first the desired result does not obtain, policymakers add complexity.

A WPT almost made it through Congress in 2005, when gasoline was a shocking $3 per gallon after Hurricane Katrina knocked out Gulf Coast refineries. At that time, the Congressional Research Service issued a report about the problems of the 1980s' version, which differentiated between new and old inventory. The Economic Recovery Tax Act of 1981 reduced tax rates on newly discovered oil, exempted stripper oil, and gave royalty owners a credit. "The structure of the WPT created artificial tax incentives based on the age and infrastructure of production and who owned the oil," CRS said, adding that the price controls were more distortive.

Because the price of oil was set in world markets, domestic producers could not shift the tax forward to consumers. Instead, refiners shifted the WPT backward to producers. CRS concluded that the WPT reduced domestic production by as much as 8 percent and made the country more dependent on foreign oil, which filled demand unmet by domestic production. Declining market prices were also a factor in the drop in domestic production.

But the WPT created jobs for our readers! It was an administrative mess for both sides. There were a million producers — including individual royalty owners with tiny fractional interests — who had to comply and file paperwork even when the price was so low that no WPT was owed. It was difficult to determine what tier oil belonged in. The IRS had to issue rulings about how to determine the removal price — one piece of the five-part calculation. One tax boutique law firm had a squad of lawyers litigating WPT cases.

Reality is a mere externality to policymakers, who believe that the precise combination of taxes and rebates will elicit the desired behavioral response (Ian Parry, "Implementing the United States' Domestic and International Climate Mitigation Goals: A Supportive Fiscal Policy Approach," IMF Working Paper WP/21/57). They think they can whack the oil majors for more taxes while not raising the price to the consumer. The assumption is that smaller producers will still produce — frackers being the marginal

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producers. But frackers aren't producing now and have relationships with the majors.

Oil companies insist that they are price takers, and that the price is set by OPEC and other foreign players. Wall Street's huge commodity trading operations have a lot to say about the price. That being said, all oil company profits are inventory profits. ExxonMobil's profits have increased by 60 percent, and its share price has more than doubled to $100 per share. It lost money in 2020 when oil was $20 per barrel. Oil is a feast-or-famine business, and half of the price of gasoline is determined by the price of crude. But proponents of WPTs believe that price gouging is going on.

A WPT can be thought of as a form of price control. Although it would immediately feed into prices, increasing them, the expected behavioral response is that the seller has pricing power and would refrain from pushing prices as high as they could go by the prospect of having the excess clawed back by the tax. When oil prices increase, the policymakers' view is that there is windfall unearned profit on old inventory — which has to be replaced at current prices.

Contracts between producers and refiners (and refiners and retailers) call for spot prices, so pricing is on autopilot. In normal times, upstream producers make inventory profits. Downstream gasoline retailers make a markup, but are currently suffering from high prices and inability to raise prices enough to compensate.

Caught in the middle are refiners, which usually have thin margins, but are now making between $5 and $10 per barrel because U.S. refinery capacity is stretched. Existing refinery capacity has been expanded, but no new capacity has been built for 50 years. The United States has lost 2 million barrels of refining capacity, while the rest of the world has been adding capacity. The huge LyondellBasell refinery in Houston will be closed next year for environmental regulatory flaws.

Excise Taxes

Legislators are trying to draft a new version of the WPT with the bugs worked out.

Senate Finance Committee member Sheldon Whitehouse, D-R.I., introduced the Big Oil Windfall Profits Tax Act (S. 3802), which would be an excise tax on crude oil with a rebate to certain individual taxpayers. Rep. Ro Khanna, D-Calif., introduced companion legislation (H.R. 7061).

Technically, the bills would impose a 50 percent excise tax on the excess of the average quarterly price of Brent crude over the average price for years 2015 through 2019, with inflation adjustments. Our economist determined the average price for those years was $57.74; others put it at $66 per barrel. With the current price roughly $120 per barrel, the tax would be roughly $30 per barrel. Excise taxes are usually deductible, so presumably this would be deductible; the bill does not say otherwise. (Prior analysis: *Tax Notes Federal*, Mar. 21, 2022, p. 1650.)

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The bill is designed to cover worldwide production but would be limited to the oil majors by virtue of a threshold of lifting or importing at least 300,000 barrels per day. So it would not discriminate against domestic production. There would be no seller profitability limit, so it would be easier to collect, because the refiner wouldn't have to know anything about the producer. It's not clear which players would be responsible for collecting this tax; the previous WPT was collected on the first sale.

The expected revenue would be $35 billion to $45 billion annually. This would be dedicated to gasoline price rebates of roughly $240 per year for single filers (phased out at $75,000 AGI) and $360 per year for joint filers (phased out at $150,000 AGI). The bill would create a trust fund for the IRS to administer the rebates, which would be claimed as tax credits and advance refunds.

Apparently the sponsors and their 20 cosponsors neither drive nor fill their own tanks. The proposed rebate would literally cover one tank of gas for a Ford F-150 in California, or slightly more, depending on where the owner lives. The annual hit to consumers is roughly $5,000, so the proposed rebate would be a gesture. Make that yet another gesture; as this article was being written, more oil was being released from the Strategic Petroleum Reserve.

Whitehouse and Khanna argued that a WPT will hold Big Oil accountable and somehow

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reduce gasoline prices. That it would somehow maintain U.S. competitiveness and decrease pressure on inflation. How's that again? At least the pair admit that Ukraine is not the sole factor pushing up gasoline prices and that the increases were already occurring before the invasion.

"The Whitehouse WPT would further increase U.S. fuel prices, dampening consumption and reducing air pollution, including carbon emissions," said Thornton Matheson of the Urban-Brookings Tax Policy Center. "These effects would be muted to the extent that smaller oil companies stepped in to replace production and imports cut back by bigger companies subject to the tax."

But profits matter to other legislators. Rep. Peter A. DeFazio, D-Ore., and 44 other House members introduced a bill, H.R. 7099, the Stop Gas Price Gouging Tax and Rebate Act, keyed off profits rather than oil prices. It would impose an excise tax on oil company profits exceeding the level of profits in a baseline period, with revenues rebated to consumers. It would be a one-time levy with a 50 percent rate. It would not be deductible from the corporate tax base.

The DeFazio bill would define windfall profit as the excess of the adjusted taxable income of a covered producer (daily lifting 500,000 barrels and earning $1 billion in gross receipts) for tax year 2022 over the reasonably inflated average profit for such tax year.

Adjusted taxable income would be determined by adding interest deductions, charitable contributions, and net operating loss carryforwards back to taxable income. Interest income, dividend income, and current net operating losses would be subtracted. Reasonably inflated average profit would be defined as the taxpayer's average adjusted taxable income for 2015 to 2019, with the highest year discarded and 10 percent added. So it would be roughly 110 percent of adjusted taxable income.

Price controls and WPTs "fail to achieve their proximate aim, which is to reduce prices paid by retail consumers, but do manage to reduce supply, increase imports, and impose steep costs on the economy," according to Peter Van Doren of the Cato Institute.

Income Taxes

Should we create a special add-on book income tax just for oil companies?

Policymakers are trying to thread the needle between scooping up oil company profits while not discouraging those same companies from production. Their goal is to reach what they dub economic rents accruing to oil companies during periods of high prices. By economic rents they mean extranormal profits — like the ones the tech monopolies and oligopolies regularly make rotting your teenager's brain. But even if they succeed in reaching rents, the tax would inevitably affect investment and production.

Simply put, investors are willing to take a punt on oil producers because the rewards, albeit uncertain, could be large. Much of the time, oil production is less profitable than other industries; it certainly has bigger swings. Other parts of the gasoline value chain are also marginally profitable.

"If investors think that they can keep natural resource rents, they will accept risk because the rewards are potentially quite high. If, after investment occurs, the government reneges and taxes windfall profits when investments are successful, but does not correspondingly help investors when returns are below expectations, then, going forward, investors will reduce their participation in energy markets because 'profits' in energy attract too much political attention relative to investments in other areas of the economy," said Van Doren.

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In a recent report, CAP argued for an additional book income tax just for oil companies, which would have higher rates during periods of high oil prices. The rate would rise and fall with prices, using a $75 West Texas Intermediate as the benchmark, which would yield a 63 percent rate at current oil prices. This scheme would raise about $25 billion annually at current oil prices and

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would be expected to terminate when oil prices went below the benchmark.

What is the mechanism for termination? "We did not specify the exact mechanism. One possibility: At some point IRS would certify that the WTI has fallen below the benchmark, and then the tax rate would be 0 percent. Then that zero percent rate would be pro-rated for the rest of the year," CAP report authors Seth Hanlon and Trevor Higgins explained.

But companies would be allowed to deduct all costs associated with current production against book income, even costs that would otherwise have to be capitalized. For economists, this provision is intended to ensure that it reaches rents and not normal profits (which it would reach without it). "The idea was that if oil companies cannot put new wells into production this year (the only type of investment that would lessen near-term prices), then they would not need to try to claim this additional incentive," said Hanlon and Higgins.

Practitioners can see that this segregation would produce endless arguments about which capitalizable costs are associated with currently producing assets. CAP also suggested determining the proportion of a large oil company's profits that are attributable to crude oil sales and restricting the tax to those. ExxonMobil does not publicly break out crude oil from upstream operations results.

CAP expects a behavioral response — that oil companies would voluntarily reduce their margins to reduce their tax hit. CAP and CRS insist that a profits tax would not increase pump prices.

"The oil industry insists they are price takers in the spot market, which is why the profits they are receiving at this price are a windfall. In the longer run, as major oil companies have told their investors, a lesson they learned from the COVID bust is to avoid overproduction; U.S. producers have reduced production from the pre-pandemic level and have not made up that deficit even in the face of the current crisis-level prices," Hanlon and Higgins explained. "The degree to which there is price fixing or other anti-competitive behavior is a matter for investigation in the fuels markets generally and the refining industry."

CAP does not explain the relationship between the proposed book income tax and the corporate income tax. Would it be creditable against the corporate income tax? Would it be an add-on? If there were no provision for the relationship, it would be an add-on. Hanlon and Higgins envisioned the tax as an add-on but were open to treatment as an expense.

"The potential appeal of a windfall profits tax, rather than, say, an excise tax, is that in principle it can tax profits without discouraging drilling or production by energy producers," said Alan Auerbach of the University of California, Berkeley. "The logic is that if companies seek to maximize their profits, and the government takes a share of profits, the profit-maximizing policy will not be affected."

But it would have a deleterious effect on production and investment. "A temporary windfall profits tax will encourage companies to wait until the tax goes away, thus restricting current production and raising energy prices," Auerbach explained.

Matheson likes the idea of a profits tax, but frets that a temporary one would affect production. "Imposing a temporary surtax on profits when oil prices spike creates an asymmetry between the tax treatment of revenue and expenses. Oil companies deduct the cost of their substantial capital investment at the standard 21 percent corporate tax rate, but their income is sometimes taxed at steeply higher rates. This creates an investment disincentive that can lower production," she said.

"CAP claims that 'since it is a temporary tax on the oil companies' windfall from the crisis, it would not be expected to alter investment decisions.' Forward-thinking investors know that politicians come after oil companies periodically so, of course, that alters investment decisions," said Van Doren.

"It's a core tenet of economics that a firm will try to maximize its profits. Whether it keeps 95 percent of those profits or 75 percent, the firm is still expected to behave in the same way: to maximize its profits. This kind of tax has no impact on an oil company's near-term production decisions," said Hanlon and Higgins.

"Our proposal is a one-time, automatically terminating, temporary tax which we think is

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unlikely to affect long-term investment decisions. More importantly, it is today's temporary price spike that we are trying to solve for, not production levels a decade from now," the pair added.

"A permanent windfall profits tax will have potentially less impact on current production from existing reserves, but will discourage exploration and development, since the after-tax returns to such activity will be reduced; this is particularly true if the tax is a one-way bet, imposed only when profits exceed some rate, with no refunds on the downside," Auerbach said.

"In the long run, such a tax is a tax on capital; it reduces the rate of return, thus reducing the supply of capital to the oil industry," CRS opined about a profits tax as a WPT. CRS would just increase corporate income taxes instead:

> While the current corporate income tax is not a pure corporate profits tax, a surtax for oil companies would arguably be an administratively simple and economically effective way to capture estimated oil windfalls in the short run. In the long run however, all taxes distort resource allocation and even a corporate profit tax (either of the pure type or the surtax on the existing rates) would reduce the rate of return and reduce the flow of capital into the industry, adversely affecting domestic production and increasing imports.

CRS argues that a true profits tax would be neutral in the short run. "Sizeable tax revenues could potentially be raised without reducing domestic oil supplies," the economists said. Because the cost of crude oil would be unaffected, so would the price of gasoline, in their view.

Other oil-producing countries have special surtaxes for oil companies. Norway and the United Kingdom, where North Sea oil is depleted, have tax laws in place that are intended to reach the windfall component of oil company profits. The new British energy profits levy is a 25 percent add-on to the 40 percent special corporate rate that British oil producers currently pay. The add-on levy permits deduction of 80 percent of production costs that would otherwise have to be capitalized — thus, it's intended to reach rents. It will be phased out when oil prices return to normal.

The European Commission advised its members that they could consider WPTs for energy companies, with the stipulation that producers be allowed to recover their costs (COM(2022) 108 final). The commission wanted consumer relief to be provided, but simultaneously wanted price signals to be preserved, to discourage use and encourage renewable sources (the EU has emissions trading). (Prior coverage: *Tax Notes Int'l*, June 13, 2022, p. 1344.)

If it's feast or famine in the oil business, why ask for a new tax whenever these companies make money? "Domestic oil producers face no new marginal costs of production, but the price they can command from U.S. consumers is now much higher, and the increase in profits as a result is a windfall," Hanlon and Higgins responded.

"We'd also note that Congress came to the aid of oil (and other) companies during the 'famine' period in 2020 by relaxing the NOL limits, even allowing NOLs to be used against the pre-TCJA corporate rate, and in other ways," the pair added (section 172(b)(1)(D)). "Congress also provided a large, sheer windfall in 2017 when it essentially made the huge corporate rate cut effective immediately. So we are not too concerned with asymmetry."

Tax Preferences

Why not just repeal oil company tax preferences?

Is book income a good measure of profitability? Oil companies use LIFO for financial accounting. ExxonMobil uses LIFO. If Congress taxes book income, LIFO would still understate it.

LIFO is still permitted for book purposes (Accounting Standards Codification Topic 330-10-30-9). There is no requirement for specific lot identification for fungible goods like oil (ASC 330-10-30-11). It's better if every player in an industry uses the same method (ASC 330-10-30-14). Reporting companies must disclose their inventory method. "The basis of stating inventories shall be consistently applied and shall be disclosed in the financial statements" (ASC 330-10-50-1). Inventory cannot be written up.

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"Entities shall not measure physical inventories at fair value, except as provided by other guidance in the other Topics" (ASC 932-330-35-1).

Oil companies are the biggest users of LIFO accounting, which allows them to minimize tax on those inventory profits. If politicians want to raise taxes on oil companies, why not just repeal LIFO? DeFazio has previously called for repeal of oil company tax preferences — which cost less than $4 billion annually and are believed to have no effect on production.

Why not just repeal oil company tax preferences?

Wyden plans to include LIFO repeal in his proposed WPT. LIFO repeal was seriously considered in Congress in 2005. CAP recommends it. "Oil companies are the largest beneficiary of the LIFO accounting method, which is essentially an accounting fiction that bears little resemblance to their actual turnover of inventory. It is simply a way for them to defer taxes on profits," the CAP report stated. Other legislators have suggested requiring revaluation of LIFO inventories.

The original WPT was a proxy for congressional unwillingness to repeal special goodies for the oil industry like immediate deduction of intangible drilling costs — which just passed its 100th birthday (section 263(c)). Biden's budget proposal would repeal 11 of them, such as credits for enhanced recovery and production from marginal wells and deductions for intangible drilling costs and tertiary injectants.

Shouldn't these things be repealed? "The best first step would be to eliminate existing tax breaks. But that would still only tax oil profits, much of which are natural resource rents, at a 21 percent rate. Most countries seek a much larger government take from the exploitation of a nonrenewable natural resource," Matheson said.

"Getting rid of energy producer tax benefits raises the cost of production, and so will at least to some extent be passed along to consumers," said Auerbach. "In normal times this would seem like a good idea, given that we have strong reasons to discourage the production and use of fossil fuels. But things are sort of turned on their head right now."

CAP suggested denying foreign tax credits for disguised royalties. This alludes to the FTC for dual-capacity taxpayers, which often pay corporate income taxes to mineral-producing countries on a different base than regular corporations (reg. section 1.901-2A). So if a special tax scheme denies a deduction for exploration expenditures, it's still creditable (reg. section 1.901-2A(a)(2), Example 1). Most mineral-producing countries impose a variety of levies on the same production of crude oil — royalties, wellhead taxes, and corporate income taxes. The defunct Build Back Better Act would have repealed the dual-capacity taxpayer provision (section 138123 of the bill).

"A tax only on profits from U.S. sales will cause sales to shift abroad, again restricting U.S. sales and raising U.S. prices," Auerbach said. Well then, repeal the GILTI exclusion, and while we're at it, tax U.S. sales of foreign-parented oil companies. CAP recommended repeal of the foreign-source fossil fuel income exclusion from GILTI tested income and loss (section 951A(c)(2)(A)(i)(V)). The Build Back Better Act would have repealed the exclusion (section 138126(e) of the bill). It would also have imposed an excise tax on share repurchases (section 138102 of the bill).

"A tax on all profits of U.S. companies but only U.S. sales of foreign companies (since we really can't tax the profits on foreign sales by foreign companies) would still encourage foreign companies to sell abroad rather than in the U.S., and will also encourage U.S. companies to invert," said Auerbach.

Gas Prices

While legislators worry about gasoline prices and their electoral chances, the executive branch is pursuing policies to discourage production.

A WPT would be passed on to consumers in higher prices. Would that be compatible with gas tax relief that some nervous legislators want? Um, no, the two would cancel each other out, according to CRS. "An excise tax holiday — suspension of the 18.4-cent-per-gallon tax on gasoline — combined with an equal revenue WPT on oil would be completely counterbalanced or offsetting," CRS said the last time a WPT was seriously considered.

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"Eliminating the gasoline tax would cause refiners to reduce prices over time by the amount of the tax (or somewhat less depending on tax incidence, which depends on the ratio of price elasticities of the demand and supply schedules), but the WPT on all crude oil (which remember is actually an excise tax) would be shifted as a higher price of crude oil bought by refiners, thus offsetting the decline in product prices," CRS explained.

"In oil tax, near-term and medium-term goals differ: We want to address the oil price spike by taking a larger share of oil company profits without deterring production, so higher profit taxes (including tax break repeals) are appropriate," said Matheson. "I don't support gas tax holidays, but the evidence is that they are largely passed on into lower prices."

> ***While legislators fret about gasoline prices and their electoral chances, the executive branch is pursuing policies to discourage production.***

European countries have explicitly linked WPTs to consumer relief. The proceeds of the British profits tax are supposed to go toward consumer relief. Italy recently enacted a 25 percent WPT on all energy producers that earned more than a hurdle amount in the last six months, accompanied by a small reduction in the gasoline tax. Greece enacted a 90 percent tax on all electricity producers that earned more than a hurdle amount in the last six months, with the intention of using the revenue to retroactively subsidize consumer electricity.

As this article was being written, the White House was looking at a federal gas tax holiday for the duration of the Ukraine conflict. The president doesn't have the power to suspend the tax; he would urge Congress to do so. Sen. Mark Edward Kelly, D-Ariz., joined by Stabenow; Sen. Raphael Warnock, D-Ga.; and Finance Committee member Maggie Hassan, D-N.H., introduced a bill, the Gas Prices Relief Act (S. 3609), for a gas tax holiday until 2023. All except Stabenow are up for reelection this year. The bill contains a statement that the desired policy is that Treasury monitor the program to ensure that the benefit is passed on to consumers.

The federal gas tax is only 18 cents per gallon, and 24 cents for diesel (sections 4041, 4081). The problem with a gas tax holiday is that gasoline retailers might economically capture the benefit. When Maryland removed its 37-cent-per-gallon gas tax, prices went down by 26 cents, so the entire benefit was not passed through to consumers. New York Gov. Kathy Hochul (D) cut the state's 48-cent fuel tax by 16 cents per gallon through the end of the year, as the local price nonetheless went to $7 per gallon. California's gas tax, the country's highest, is 87 cents per gallon.

Consumer relief is antithetical to the green agenda, as the Europeans recognized. Policymakers oppose gas tax holidays. High gas prices are desirable in their view. In an April 7 Tax Policy Center interview, Ellen Hughes-Cromwick of Third Way called gas tax holidays "a very limited fix." But a WPT would discourage investment, including in renewable energy. "We need these companies to be investing in alternative and clean energy solutions," she said, acknowledging the barriers to entry in energy.

"Beyond the immediate crisis, the larger goal is to fight climate change. Instead of trying to lower fuel prices, policymakers should 'accept the gift' for now and phase in higher fuel taxes as market prices subside," Matheson said.

The Obama administration wanted gas prices at European levels to discourage use. White House press secretary Karine Jean-Pierre reminded Americans that their gasoline is still cheaper than the gasoline used by Europeans. She failed to mention that Europeans' consumption is subsidized by the United States, they have good public transit, they have short distances to travel, and they choose to levy high taxes on gasoline, which are a large component of the price.

European gasoline has higher octane, making it go farther in high-compression engines. European gasoline does not have ethanol added. Ethanol makes fuel less efficient and wrecks engines because it has water as a byproduct. Yet the Biden administration EPA proposed to change the renewable fuel standard to retroactively increase the required amount of ethanol in gasoline from 10 percent to 15 percent (EPA-HQ-OAR-2021-0324, 86 F.R. 72436 (Dec. 21, 2021)). The EPA did invoke the notice and comment procedure. The American Fuel and Petrochemical

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Manufacturers called the new requirements "unachievable." There are tax credits for putting ethanol in gasoline (section 6426).

There was no environmental justification for this — ethanol pollutes. Oh, but we have to pay the farmers for all that corn! There's nothing wrong with subsidizing farmers. There is something wrong with putting food in gasoline, when that food is the feedstock for beef cattle and high-fructose corn syrup that is in most American prepared foods (even your English muffins!). It increases the price of beef, chicken, and eggs. It contributes to what may be high gasoline and food prices for the next two years. And shortages. Two years is the approximate amount of time for a domestic oil project to begin producing, assuming willingness to invest.

"We must feed the energy system we have today, which runs on fossil fuels, while also working toward the future transition away from such fuels. The energy system cannot stop using fossil fuels overnight," said Samantha Gross of the Brookings Institution. ■

NEWS ANALYSIS

Inventories, Inflation, and Supply Chain Disruption

by Martin A. Sullivan

> *I think we're going to see a new era in how we manage this type of thing. My hope is people are going to give more thought to the importance of carrying inventory and safety stock so that we can survive some of these disruptions, especially around critical commodities.*
>
> — Professor Willy Shih, April 23 interview

Deeply ingrained in the ethos of U.S. tax policy is the idea that investment in plant and equipment increases productivity and promotes economic growth, so we provide favorable tax treatment. There is an even stronger case for investment in research because the knowledge creation provides benefits to far more entities than just the business bearing the cost, so we favor it as well. Investment in inventories, on the other hand, gets no respect.

Cost-conscious business managers see large inventories as evil. Economists are no better. Their models include the costs of inventories, but only in extremely rare cases do they incorporate benefits. Perhaps this partial blindness results from the fact that costs of inventory are so large and measurable (financing, warehouse space, obsolesce) while the benefits are so amorphous (customer satisfaction, economies of scale in purchasing).

At the macro level, violent swings in inventory levels are behind a lot of the volatility in GDP. And forecasters view increasing inventories with foreboding because they can indicate an upcoming recession. Nevertheless, increasing inventory levels *is* investment. And just like the case of investment in fixed capital, the level is set — taking into account costs and the uncertain future — to maximize expected future profits.

Supply Chain Run Amok

Baby formula. Semiconductors. Tampons. Construction materials. Shortages from snapped supply chains have elevated the formerly obscure art of supply chain management into a top

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