EXECUTIVE SESSION

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WEDNESDAY, OCTOBER 10, 1979

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

The Committee met, pursuant to notice, at 10:30 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long, Chairman of the Committee, presiding.

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

The Chairman: The Committee will please come to order. What do we suggest by the way of making progress that we might consider the first item this morning?

Mr. Shapiro: We can go back to one of the modifications that we discussed last week with regard to the payment schedule.

The Chairman: Which?

Mr. Shapiro: The payment schedule on the taxes. This is an adjustment to the House bill.

The House bill requires a semi-monthly payment.

The Chairman: Yes, sir.

Mr. Shapiro: Subsequent to the House bill, the staff had a number of discussions with independent refiners and we now have determined that there really are problems and inequities in the House bill with regard to the independent refiners, for this reason.

The tax is imposed on the producer. The producer has to pay the tax, or the tax is imposed on him, that is. However, for convenience, the first purchaser has to pay the tax. So here you have a tax that is imposed on the producer, but paid by the first producer, who is generally the refiner.

The reason for that is that there are thousands of producers and when you add the royalty holders it multiplies that many times over, but the refiners are only a couple of hundred, so it is a lot easier administratively to deal with a few hundred refiners for purposes of collecting the tax than it is possibly hundreds of thousands of producers and royalty holders.

When you ask the first purchaser, the refiner, to pay the tax on behalf of the producer, in many cases that may be they will have to pay the money before they have received the money from whomever is purchasing the oil from them. In other words, the refiner has purchased the oil from the producer and the refiner sells it and the refiner may not be paid by whoever buys the oil from the refinery until sometime in the future, but they may have to advance the money ahead of time.

That did not seem to be fair.

What the staff is suggesting for the Committee with regard to the major oil companies, the integrated oil companies where the cash flow problem is not as significant, this is in response to the Committee discussion you had last week to retain the House provision, which requires semi-monthly payments and just put in a provision that requires it to be done on an estimated basis, on a similar basis that you have essentially for the income tax today. Then they will have to make a quarterly return, so they would even up on a quarterly basis.

Meanwhile, they would still have to pay the semi-monthly estimated payments. In this respect, you would not have the revenue loss that would be the case if you had delayed payment.

However, in the case of the independent refiners, it is more of a cash flow problem in their cases because many times they have what is referred to as deferred payment contracts. They will buy the oil from the producer. Because they do not have the cash flow in most cases that the major integrated oil company will have, they will agree to defer payment and not pay the money to the producer until they receive it from whoever buys the oil after the refinery process.

So that the proposal that we would like to suggest to you in the case of an independent refiner, they will have thirty days at the end of the month to pay it, unless they have a deferred payment contract, in which case they would have 60 days. It would be up to 60 days. In other words, it would be up to the type under their deferred payment contract, whenever they would have to pay under the deferred payment contract up to 60 days.

The estimate that we have on that is that we would have on that is that it would reduce the revenues by approximately $200 million in the first fiscal year -- that is, moving from fiscal year '80 to '81; a $200 million effect.

The Chairman: How would it have reduced revenue if we had taken that first recommendation?

Mr. Shapiro: The first one would have been $800 million.

The Chairman: So, for budget purposes it would save at least $600 million of the $800 million by doing it this way?

Mr. Shapiro: That is correct. Once again, this is not a revenue loss in the long run. This is just putting it from -- it is a fiscal year drag, because you are putting the collection 30 days later.

The Chairman: By doing it this way, we have at least $600 million more available for the first fiscal year than we would have otherwise.

Mr. Shapiro: That is correct.

The Chairman: I hope that we do that.

Senator Dole: I do not have any objection to the first part of that. It seems to me we do not affect that $600 million figure if we just make it 60 days across the board for payments to independents. Does that change that figure?

Mr. Shapiro: It would affect it some.

Senator Dole: But not much?

Mr. Shapiro: We think that it could be as much as $100 million. We do not know. We do not know exactly how many had these deferred payments contracts.

Keep in mind that any refiner would be automatically covered under that 60 days if they had deferred payment programs. It may be the reason they do not is because the producer would not agree to that.

The way we focused on that, if a producer does not agree, the refiner is not out of pocket. If you did not have a windfall profits tax, the refiner would have to pay $22 on each barrel to the producer with the windfall profits, instead of paying the producer $22, he is paying the producer $18 and $4 goes to the government for the windfall profits.

The refiner would not be out of pocket; he would only be shifting it. If he has a deferred payment contract, he would be out of pocket. That is why the 60 day suggestion with the deferred payment contracts instead of across the board.

The Chairman: I think that is the best way to do it. As I say, in the long run, it works out to the same figure, but by doing it this way the government receives a lot more money in the first fiscal year and we still give them $200 million relief compared to what the House bill would do.

I would hope that we would do that, just because we need the money for budget purposes.

Is there any objection?

Yes, sir.

Senator Dole; I do not know if I have any objection or not. I assume for the record to be clear, we are talking about the largest 16 integrated oil companies.

Mr. Shapiro: Yes. What we want to use is the same definition of the independent refiner that is used under the regulatory program for oil and gas. It is a definition already provided. The Emergency Petroleum Allocation Act has a definition of the term independent refiner. We are picking up the same definition already in the law.

Senator Dole: Unless there is some strong reason, it seems to me that we have had a chance maybe to defer the check on deferred payment contracts and maybe have a better estimate of what we are talking about.

I understand the problem, the budget problem, and I agree with the first part of it on the estimated payments on estimated basis. I do not see that we do any violence to the independent refiner if we grant 60 days across the board.

We are talking about 28 percent of the oil.

Mr. Shapiro: It is in the range of approximately close to that, 30 percent, in that range.

Senator Dole: Which satisfies the Chairman's question the other day, some way to recover, to get a payment up to maybe 75 percent of that. There may be some way we could adjust the latter half of that formula, but we are going to go to conference with the House. I do not know what objection there is to have 60 days. Do you have any strong objection to that?

Senator Moynihan: Mr. Chairman, may I ask if this has any impact upon Alaska, because you see what is happening outside?

The Chairman: That is Alaskan weather moving in to get us conditioned to vote on that Alaskan pipeline. It is not going to make any great difference to me, one way or the other.

When a refinery -- assuming that you do not have, assuming that you are not going to have a deferred payment, so when the refiner buys the oil, let us say the oil is worth $20 a barrel and at that point he withholds from the producer, let us say, $4 a barrel to pay the tax.

So he gives the producer his check for $16. There is really no reason why, at that point, when he wittholds that money from that producer, why he cannot mail us that check right then and there.

Now, in the long run, we get the money anyway. I do not see any point in leaving the fellow with that money during the interim. Otherwise, he can be making interest on that money by sitting around with money that belongs to Uncle Sam and we would be $100 million better off in this year's budget if we just told him he would have to mail it in.

Mr. Shapiro has suggested that a deferred payment contract is different. In that case, he says he does not have the money to pay the guy until he sells the oil, and so, okay, if that is how it is, when he sells the oil, he gives the man his money. At that point, he gets this, right? That is how it works?

Mr. Shapiro: Correct.

The Chairman: But if he does not have a deferred payment contract, why does he not, in view of the fact that he is not going to pay the man for the oil, all the oil that it is worth, why does he not just go ahead and mail it to us? From our point of view, that is $100 million he could pick up from this year's budget.

Senator Dole: They are not certain of that.

I think even on a nondeferred payment, I think it is a question of paperwork. For the majors, most of it is their own oil, a great portion of it. They do not have any problem with payments. It is their oil. They are paying the tax on it in any event.

I do think there is a different case for independents. Maybe there would be some way to compromise the difference between 30 and 60 days that would allow 45 days, or do it your way the rest of this fiscal year and 60 days next year. That would have no budget impact, and see which system works. If they can do it in 30 days there is no problem. I do not know how many have delayed payment contracts, how many are 60 days, how many are 90 days.

Do we have any estimates on that?

Mr. Shapiro: No. We have talked to the independent refiners. The impression we have is that there used to be a longer delay in the contracts and they are now accelerating those contracts. The delay is not as long as it used to be. I think it was typical that they were between 60 and 90 days in the past. Now there are less deferred payments contracts and they have been speeded up so they are in a much shorter period of time.

From talking to those whom we have talked to, they seem to be about the right period of time to extend it to cover most of them. Of course, there will be a few that are longer from the standpoint that we have talked to them. We cannot say with any certainty as to what the universe is in all their contracts.

Senator Dole; Can we say with any certainty that we are talking about $100 million?

Mr. Shapiro: It is just a rough estimate based on what we know from talking to them.

Senator Dole: It is not a question that the tax would be collected, a question whether it would be collected this year or next. I guess that is the budgetary problem. No one is going to avoid the tax or evade the tax or not pay the tax.

Again, we are talking about a different type operation. If you made it 45 days, would that complicate matters?

Mr. Shapiro: Once you make it without a deferred payment contract, any amount, 35, 45, 60 -- the revenue estimate that we have is pretty certain because we know how much oil there is and what the time delay is, but we cannot tell you for certain, when you say up to a certain amount of time on deferred payment contrats.

Senator Dole: Forty-five days and sixty days on delayed payment contracts.

Mr. Shapiro: What Jim is suggesting is that the 45 days does not really have a fiscal effect because it is very close to having the same fiscal effect whether you have 30 or 45 days. If it is the end of 30 days, if you have any time within that month, you are going to collect it before the end of that period of time anyway, so 30 to 45 will not have a fiscal year effect.

Mr. Wetzler: I think we assume that it takes five days or a week or so for the money to get to the Treasury. If they send in the check December 15th, I think our estimate is that we would assume that gets into the Treasury by the end of the fiscal year, and going from 30 to 45 would not cost you any money.

The Chairman: Give me that again.

Mr. Wetzler: I will have to check with our estimators. I think the assumption he uses is that it takes a week to ten days from the time that the refiner sends in the check to the time that the Treasury actually gets it and deposits it. If that is the assumption, going to 45 days would mean that they would mail the check September 15th. If they did that, we would still get it in before the end of the fiscal year.

That means if Senator Dole proposes going to 45 days, that would not cause any more revenue than 30 days.

Mr. Shapiro: The period we are talking about is a month, August 1 to August 31. I am sorry, July 1 to July 31st.

What we are saying is that they would have 30 days to pay after that. That would mean that they would have to mail their checks after August 31, which means that the check could get to between September 1 and September 10th or so, about five days. If you give them 45 days, which means having to mail the check on August 30th, they have until September 15th. It would still take that same five days ago and it would get there before the end of the month and it would be included for that fiscal year.

The Chairman: It would not cost you any money to do it that way?

Senator Dole: Thirty or forty-five days.

The Chairman: It would not cost any more money?

Mr. Shapiro: Based on the way that we understand it. From receiving the check, it would not have any effect on the fiscal year.

The Chairan: All right. If there is no suggestion, then we will accept the staff suggestion as amended by Senator Dole.

All right.

Senator Danforth?

Senator Danforth: Mr. Chairman, at some point I have this amendment with respect to state governments. I know Senator Bentsen wanted to be here at the time that I offer it. I do not know what the appropriate time would be, but I am prepared to do it at any time.

The Chairman: Fine. I would suggest that the staff said Senator Bentsen, that you would like to offer your amendment and come on over. Meanwhile, we will go to Senator Wallop.

Senator Wallop: Mr. Chairman, before we leave this subject of the collection of payment of the tax, I would just like to ask Mr. Shapiro if it is not possible that, due to the net income limitation provision of the bill, that the producers with high-cost properties may be able to overpay their tax and simply be denied use of their own money over an extended period of time over the provisions that now exist.

Mr. Shapiro: In some cases it may be, but they will be eligible for a quicky refund. As you are saying, they would like to get it back quickly.

Senator Wallop: I am asking whether they would be eligible for a quicky refund or whether we need -- if we need an amendment to the bill to provide them that flexibility.

Mr. Shapiro: I think the point is a valid one. What you are just suggesting is to have a quicker refund procedure so they can get it in a case where it does come to play. That could be something we could work out in the bill.

Senator Wallop: Thank you very much. I am sure that would be appreciated.

The Chairman: That takes care of your matter, does it not?

Senator Wallop: That does.

Sometime I would also like to raise the trigger phase-out of the bill, at any time that you suggest.

The Chairman: Suit yourself, Senator. I think there are probably one or two Senators, probably one who would support you and some who might not support you.

Senator Wallop: That has been the way ever since we started.

The Chairman: It is all right with me. If you want to bring it up now, suit yourself.

Senator Wallop: If it is all right with the Chair, I would just as soon bring it up.

The Chairman: All right.

Senator Wallop: In essence what we would do is provide a phase-out mechanism and answer some of the problems that have been raised by members that there was a tax expenditure involved. Whatever figure the Committee ultimately decides is the figure it wants, the procedure would not be affected by the amount.

When we achieve 90 percent of that figure on the basis of 3 percent a month, that oil that was still subject to the tax would be discounted from the tax, a three year, or 30 month, phase-out. We would achieve roughly in the neighborhood of 110 percent of the amount of money that we set out as the desire of the Committee.

Whatever it came, even after conference. The ultimate figure would not matter, because we would achieve the figure. We would achieve a phase-out at the end in whatever time. If we achieved it in 1995, that is when it would start to phase out. If we achieved it in 1986, that is when it would start to phase out.

There would be no net revenue effect on what the Committee and Congress ultimately decides to do.

The Chairman: Is there any discussion? We had better ask Treasury what their position is on the matter.

Mr. Sunley: We would be opposed to that. As you well know, the amount of revenue we are going to get from this tax is dependent on a number of assumptions. Obviously, the expenditures are also highly sensitive to the various price assumptions.

As you well know, this Committee, at any point, can review the decisions that they have made in any legislation and terminate the tax at some future date. I do not think that we want an automatic termination of this sort in the bill at this time.

Senator Wallop: We assumption that we have been operating on from the very beginning in every single issue, though some of us have tried to say that it is too modest, the argument of Treasury has been, the argument of everyone else, that we cannot use a greater assumption.

I would use the same argument that Mr. Sunley uses. If this all takes place at a greater and more accelerated rate somewhere down the line, there is nothing to prevent the committee from deciding that the desires of the Committee at the time it passed this tax were unfulfilled, that we would have to extend it, or raise it, for a period of time.

It is a question, really, of which way is appropriate. We have been told at the beginning that the purpose of this was not to raise a general amount of revenue, that we were specifically having a windfall profits tax to achieve certain goals.

What I am suggesting, when we have decided what those goals are based on the assumptions that are in here, that we begin basically a measured triggered phase-out, that does not have a net revenue loss to what we have done.

I would also say that I do not think that it is appropriate for Treasury to use a different set of assumptions when it comes to triggering it out than it does to measuring the effects of the tax as we proceed right now.

The Chairman: Senator Moynihan?

Senator Moynihan: Mr. Chairman, let me put a question perhaps to the administration, perhaps to the Committee. I guess that I might have a different understanding of our task here from Senator Wallop, although I understand perfectly clearly his point of view.

I had thought that what we were doing was to take a portion of the increased revenues that are going to the oil industry as a result of price increases and putting them to other purposes including compensating citizens who are going to have higher energy oil bills as a result.

One of the driving forces in this increase as we expect is the world cartel, which keeps raising prices, and I remember Dr. Schultz's engaging description of the bill as the OPEC rip-off tax, after a point as OPEC keeps rising -- we do not want to get too many persons in the economy with a vested interest in OPEC's continuing to raise its prices. That is not their fault, but they would acquire it such that I see this as taking a rate of the revenue increase rather than as a fixed amount of revenue. That may not be the way that others see it, but for example if I am not mistaken -- and probably I am and Senator Wallop can correct me -- supposing that OPEC raised the price of oil to $100 a barrel. Well, the near-term effects would not be as great, I fear, as we think long-term would be. We might find that we have raised a fixed amount of money under this tax by 1983 and that is precisely a circumstance where we would not want the tax to cease to be levied.

Am I wrong?

Senator Wallop: I would suggest that that would be a mechanism that the Committee would readily seize on as a reason not to continue the phase-out.

Let me continue also from the beginning of the whole discussion, the reason that people wanted a trust fund in the first place was to dedicate a certain amount of money and to protect it from other bites that might be taken by the Congress, protected from the general fund. That was the argument made in favor of the trust fund.

All I am saying is, if that is the argument, that there is a recent amount of money that is to be dedicated for these other purposes, identified by the President, and other members of Congress.

That is what we should do, and when we achieve that, the goal was not to just perpetuate the trust fund, perpetuate zillions of dollars at the expense of one segment of the economy and the recovery mechanism does exist in the income taxes.

Senator Ribicoff: I think that the point that Senator

Moynihan makes is as the price of oil keeps going up by OPEC, the needs of the trust fund will be greater because all the charges that would be levied against the trust fund would automatically go up with the price of oil going up.

Just yesterday's paper indicates that Kuwait and others are raising the price of oil now. It is very obvious that you are going to have an accelerated increase of costs which will increase the cost for the projects dedicated in the trust funds. So I agree with Senator Moynihan.

Senator Wallop: Senator Ribicoff, if I may respond then, from the very beginning, Treasury and the Joint Committee has been resistent to the point that it might be accelerated. Every argument before this committee has been that we are going to have GNP plus 1 percent. That is the assumption on which every bit of revenue measurement has been made and any time that people have suggested that that was too conservative, we have had a triggered reaction on the part of Treasury that says, not at all.

You cannot base anything on that.

Senator Ribicoff: As I follow what this Committee is doing, we are paying absolutely no attention to the Treasury as it is. Why pay attention to them on this?

I think we have to draw our own conclusions, which we are, as to where the trends are going and with all due respect to the Treasury, they are doing the best they can under very diffcult circumstances, but I do not see that the group around this table is paying too much attention to them.

The Chairman: They are doing pretty well. They are not winning them all, but winning some.

Senator Bradley: If I may address Senator Wallop's point, we have to the best of our ability established in 1979 how we want to spend the money between now and 1990 and made certain assumptions on revenues. It is possible that, indeed, our assumptions on revenues might be wrong, and we might get a lot of money sooner because OPEC raises its prices.

It is also possible that four years from now the circumstances in the country might be such that we might want to alter the way we want to spend that money.

Therefore, I think to say now that we have a fixed amount over a ten-year period and when we reach that it is going to phase out, I think is short-sighted of the potential changes on the expenditures side.

I personally would have no problem saying at a certain period of time, after three years, after four years, when the revenue that we want has been achieved, we review it and decide whether we want to spend it more or whether we want to phase it out. I think that is a legitimate thing. I think that I would like to see a report annually or every two years on indeed whether the windfall profits tax have progressed, as we said it has, and whether the expenditures we have approved are achieving their ends.

Senator Moynihan: If the Senator would yield?

Would that be a possible function of an annual report of the trust fund?

Senator Bradley: It certainly could be a function of the annual report, as long as we do not lock ourselves into a phase-out, we could consider at the end of one year, annually, or at the end of three years, five years. If we find a $100 OPEC when we get a lot of money immediately, maybe there is a need for some other kind of expenditure where we do not need that kind of phase out.

With a $100 tax, maybe we will put more money in solar sooner, or put more money into syn fuels sooner, or cushion it for low-income people more.

I think that we ought to preserve that option.

The Chairman: Let me see if I understand the proposal. The proposal is that when the tax has collected the amount of money estimated to be collected over what period, ten years?

Senator Wallop: Whenever that occurs, Mr. Chairman. Whatever we decide on as the amount of money that we seek to achieve by the imposition of a windfall profits tax, then it begins to trigger out.

So that there is no revenue loss which has been part of the objections that other people have raised to other phase-out proposals.

The Chairman: So that if you raised more money than you estimated it would phase out sooner because you raised more money than you estimated. Is that how you understand it?

Mr. Shapiro: Yes. The only problem the Committee is going to have to focus on in that regard, if you agree to the amendment, you would have to have a specified figure. You have to know whether it is 90 percent of the amount, presumably, what Senator Wallop has in mind, the amount that the Committee actually agrees to at the end.

Senator Wallop: Yes, and the Congress ultimately agrees to.

Mr. Shapiro: That is right.

If I could answer one of Senator Bradley's questions before you go on, Mr. Shapiro, I would suggest that it is always much easier to raise a tax than to get rid of one, much easier to sustain one than it is to lower it.

Senator Bradley: I do not know. I would rather end a tax than levy one, myself. It is much easier to levy a tax.

Senator Wallop: This is a proposal.

Senator Bradley: It is harder in New Jersey, I will tell you that.

Senator Wallop: At the time that we have achieved the goals we have set out to proceed, this is a proposal to end it without a loss of revenue.

Senator Bradley: My point is we are setting goals now as we perceive the future and we are setting revenue goals as we perceive the future. If you say that you phase out the tax after we have achieved our revenue goal, then you are saying that we can perceive the future in expenditures, but we cannot perceive the future in revenues.

Senator Wallop: I did not create the ground rules for the argument that we have been engaged in since we have started. This was the President's proposal. There were cerain things to achieve, a House proposal that said there are certain things to achieve. We feel there are certain things to achieve.

This is the ground rules of the argument that we have had from the beginning. I agree with you that things might change, but there is going to be a powerful amount of general revenue available to take care of those needs at the same time.

Senator Bradley: Well, I understand that argument. The President's wishes have never been the command of the Committee since I have been here.

Senator Wallop: They did create the ground rules or the turf on which the argument has been conducted from the beginning.

The Chairman: Do I understand the Senator is not fixing any particular figure? He is saying we should fix a figure, how much we think the tax should collect. When the tax collected that much, it ought to be phased out?

Senator Wallop: Yes, sir.

The Chairman: Call the roll.

Mr. Stern: Mr. Talmadge?

Senator Talmadge: No.

Mr. Stern: Mr. Ribicoff?

Senator Ribicoff: No.

Mr. Stern: Mr. Byrd?

Senator Byrd: Aye.

Mr. Stern: Mr. Nelson?

(No response)

Mr. Stern: Mr. Gravel?

(No response)

Mr. Stern: Mr. Bentsen?

(No response)

Mr. Stern: Mr. Matsunaga?

(No response)

Mr. Stern: Mr. Moynihan?

(No response)

Mr. Stern: Mr. Baucus?

Senator Baucus: No.

Mr. Stern: Mr. Boren?

Senator Boren: No.

Mr. Stern: Mr. Bradley?

Senator Bradley: No.

Mr. Stern: Mr. Dole?

Senator Dole: Aye.

Mr. Stern: Mr. Packwood?

(No response)

Mr. Stern: Mr. Roth?

Senator Roth: Aye.

Mr. Stern: Mr. Danforth?

Senator Danforth: Aye.

Mr. Stern: Mr. Chafee?

Senator Chafee: Aye.

Mr. Stern: Mr. Heinz?

(No response)

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: No.

Mr. Stern: Mr. Chairman?

The Chairman: Aye.

Seven ayes and five nays. We will have to hear from the absentees to decide whether the motion carries or not. The absentees are Nelson, Gravel, Bentsen, Matsunaga, Moynihan, Boren and Heinz.

Senator Packwood: I vote aye.

Mr. Stern: Mr. Packwood votes aye.

The Chairman: When we hear from the absentees, we will know what to do about that.

Is there some other matter that the Senators want to bring up?

Senator Gravel: Please record me.

Mr. Stern: Mr. Gravel votes aye?

Senator Gravel: Yes.

Senator Byrd: Mr. Chairman?

The Chairman: Yes.

Senator Byrd: Is it possible to bring up other matters at this time?

The Chairman: About the windfall tax?

Senator Nelson: Record me no.

Mr. Stern: Mr. Nelson, no.

Senator Byrd: About solid waste.

The Chairman: I would prefer to get through the tax matter first. Mr. Gravel, do you have a matter? There is a matter about Alaska we might vote on that we are discussing.

Senator Gravel: There are two items I think we can clean up very briefly.

One was the tax matter on the adjustment. The House bill, as Mr. Wetzler indicated yesterday, had it indexed to inflation. That is where the cost was. That really was not what I would like to do. I do not think the Committee would go for the indexation with respect to inflation, because of its cost. So I would hope that we would just take into consideration that if there is a change by FERC of what the tariff will be, that that change will not be treated as a windfall, because it will fall n another part of the corporation's activities.

The Chairman: What is the Treasury's position on this amendment?

Mr. Sunley: Mr. Chairman, I think that we should realize that the Alaskan oil that was selling at $5.25 per barrel is now selling at very near $13, the control price. If controls were extended, any of these kind of adjustments that Senator Gravel is talking about would not have any effect on the price at which they sold the oil because $13 was the price.

The basic thrust of the tax proposal is to tax the increases in price. The increases in revenue are due to price increases above the control level.

It seems to me that the administration was quite sympathetic about the Alaskan situation by giving them a $13 base price. I do not think we should also have a tax adjustment.

Senator Gravel: I am not sure what the recommendation is.

Mr. Sunley: We are opposed.

The Chairman: What is the difference if you made an inflation adjustment and do not make an inflation adjustment on that matter?

Mr. Shapiro: The difference here, starting out in the House bill, there was an arbitrary figure of a $7.50 base price. What the House decided to do was to make two adjustments, one for inflation and one for the tax adjustment based on inflation. Essentially what that was doing was to say, in real terms, the value of the pipeline costs go down, then you would make an adjustment on the base price, raising it, which would reduce the impact of the windfall profits tax on Alaskan oil.

The fact that the administration has made its proposal to put in a second tier, remove the necessity for having inflationary adjustment in the tax, the same argument that the Ways and Means Committee had, was no longer as important in this case.

What Senator Gravel is suggesting right now is not an inflation adjustment on a tax, but when there is a change in the nominal value of the pipeline.

The example I give is this. First of all, let me say the same people who own the oil own the pipeline, so it is the same pocket, whether it is in the pipeline pocket or the production pocket.

If the cost of the pipeline, for example, $6 is reduced to $4, what happens? The companies get $2 more. Instead of getting $2 in the transportation pocket in the pipeline, they get $2 more in their production.

The question is, is there a windfall profit on the change from the pipeline turf, from the transportation costs to the production. Senator Gravel's amendment is saying, if the pipeline charge is reduced from the present level of a little over $16, and that is done by FERC or the court case, that is occurring right now, that that should not be a windfall, that the companies would be getting $2 more, but not because of a windfall but because of the transportation costs being shifted from the pipeline to the production level.

For purposes of revenue, we are assuming that the court case that is presently in existence will not be successful. Therefore, the pipeline charge would still be the same level. Therefore, we assume a revenue cost of approximately $10 million a year in this.

In the future, if the pipeline charge is reduced, it means that it may have a high revenue cost, but the question is, is that a windfall, meaning that the producer may get more money, but it is going to the same pocket. It is going into a different pocket, but it is the money the producer is going to get either his transportation or his production costs.

So the inflation adjustment that Senator Gravel was discussing yesterday or what was in the House bill that had a big revenue cost of $5 billion, is not what he is proposing today. It is just when the cost of the pipeline is reduced. It is has nothing to do with inflation. The cost is reduced from $6 down to $5 to $4. It means the producer can get more money.

The Chairman: Let me ask you now. In terms of budgetary matters, is this matter figured into the estimates one way or the other?

Mr. Shapiro: It is assumed right now that the case will not be won and the pipeline charge will stay the way it is, the way FERC has originally set it.

The Chairman: That is the assumption that you have?

Mr. Shapiro: That is correct.

The Chairman: All right.

So without this amendment, if Alaska won the case and they had to reduce the pipeline charges, the Federal government would pick up most of the money, would they not? That is how it would work out.

Mr. Shapiro: 60 percent of it.

The Chairman: Because the ordinary taxes would be paid anyway, so this would say if Alaska won the case, the revenue to the government would be the same as it would have been before, That would be what it would amount to.

Mr. Shapiro. The Federal government is getting the income either because of the pipeline income or production income. It would not affect government incomes as all except as to windfall profit.

Senator Gravel. The case in court initiated by the

Federal government was to have oil pipelines in the United States treated like gas lines and this would be the first time. If the Federal government is successful in this, it will alter the economics of all oil pipeline transportation systems, because they will make it apply to all of the pipeline systems.

So the Federal government initiated this. The State of Alaska joined with the Federal government. The point that Mr. Shapiro is making and the point that I am making, if there is a windfall, it is occasioned by an act of government, not by the pricing of other people in the world.

So it gets to be a little capricious, or Catch-22. The companies, for round figures -- just to repeat the figures ---they file a legitimate tariff at $6. The Federal government says no, that is too high. Your tariff should be $4. If they succeed in bringing it down to $4 after litigation, obviously it is cheaper to transport the oil, so you raise the value of the oil at the wellhead.

Now, that the value has been raised at the wellhead, you tax that extra $2 value at the rate of 60 percent because you say it is a windfall profit. It is totally unrelated to the world pricing of oil. It is only related to the capriciousness of government, where it gets to be a real serious double-whammy.

The file the original at $6 because of a change in the rules and a forcible change by government of the economics.

You are taking $2 away there -- or rather, you are shifting that $2 to another part of the stream and then you are grabbing 60 percent of it just in tax revenues.

The consequences of this are serious for the companies in question but where they are more serious is here you are going to see another invasion of the government's coming in and altering the transportation cost of oil throughout the United States and when they alter it, we will have a leg to come in to tax those. They will be able to tax the new wellhead value in Texas, Louisiana, Kansas, anyplace else, to get more revenue to the Treasury, and that is fine.

We are going to be surprised, when we have put this in motion, as to what the national consequences would be, because not only would it raise more revenue in Alaska, if that is what we want to do, I would say anybody who wants to raise revenue for the United States government should vote against this exception because the ramifications are going to be to go right back into the bowels of the energy industry, and under this precedent that may be set in court is to go ahead and just take more money just as a matter of course.

And it would be just as a matter of course. I would not think they would have to come back to Congress because if they win this court case after the way oil is transported, the way it is figured out economically, then obviously anything that goes back to all of this upper tier oil in any state is now obviously going to suffer this new windfall profits tax.

That has nothing to do with the price of oil, but what the government capriciously can rip out of industry.

Senator Byrd: Senator Gravel, is the revenue impact of your amendment $10 million?

Senator Gravel: $10 million. I do not know where that $10 million comes from.

Mr. Wetzler: Our assumptions that we use for revenue estimating assume that the pipeline tariff stays constant at a value of $6.18. Under that assumption, Senator Gravel's amendment would give them an upward adjustment to their base price of 8 cents a year. That is where the $10 million comes from.

If we are wrong and if FERC or the courts lower the pipeline tariff rate under $6.18, the amendment would have revenue effect, but under the assumptions we are using, it is $10 million.

Senator Gravel: What is key there, that revenue effect is just what I predicted. They would take the money that the oil companies are charging for the transportation of oil, not permit them to have that charge, move that down to the wellhead and now tax that, and of course you would have a revenue effect. But now, you must calculate, in your own minds, if you do it here and it is based on case law and this is written into Federal law, then the Treasury will have an additional windfall because they will now be able to go back and evaluate all the properties at wellhead value and say hey, we just won a case. You have to change your transportation costs. Everyone has to lower their oil transportation costs.

After you have done that, you have to increase your wellhead value and so now that is not your money. 60 percent of that is the Federal government.

I just want to tell you.

Senator Dole: Does Treasury support this amendment?

Mr. Sunley: We are running quite a risk here. You should realize for every dollar that the pipeline tariff falls, I think the court ---the FERC regulatory action involves more than a dollar. We are talking about $300 million in revenue per year, assuming 1.3 million barrels of production. I think that is a rough guess.

What Jim has told you, if it is $6.18, which is the magic number in the model, which just happens to be 8 cents lower than the $6.26, it is nickels and dimes. That does not take into account the possibility that, in fact, the Federal government and the state will prevail in which case the amount of revenue involved under this tax falls $300 million a year.

Senator Gravel: Senator, that is the whole point. That is revenue that nobody ever expected to get. Right now, that is in the cost of transportation.

They are forcibly lowering the cost of transportation and, in so doing, raise the revenue at the wellhead by what they have lowered the transportation costs, by recalculating those economics.

Now, that is a windfall created by the bureaucracy in question through litigation. When that happens, they are claiming well, it has a bad revenue effect. We should get 60 percent of that money.

They created the windfall and therefore say now they should get 60 percent of that as revenue to the Federal Treasury when, in point of fact, what they did is recalculate the economics of transporting oil, took away a portion of that from the oil companies who are transporting it, and incidentally, these are all regulated utilities. This is a common carrier. We are not talking about even a semblance of excess profits. It is whether, in this particular case, how you handle the deduction of interest.

I am sorry I did not prepare for it. I could have had a breakdown of the case itself but the broad lines are that we treat gas lines in one fashion and we have been treating oil lines in another fashion, and the entire economics of the nation are built on this.

Now, if they win this one court case, they are going to alter all the transportation and economics of oil and they are going to move a sizable chunk of well, God knows how many billions of dollars they are going to move from the transportation system to the wellhead and Treasury is going to step forward and say, "That is all our money. That is a windfall."

And it has nothing to do with what happens outside of the United States. It has to do with what happens in court.

The Chairman: Mr. McGregor, would you like to be heard?

Mr. McGregor: Mr. Chairman, certainly the Department of Energy concurs with the position of Treasury, as far as the administration views. However, perhaps I can shed a little bit of light on the regulatory situation before FERC, as we understand it, and that can shed some light, perhaps, on Senator Gravel's amendment.

There are three separate pipeline proceedings before FERC as of today. One involves the tariff itself, what is the appropriate rate based on rate of return and includable items on that.

Two other pipeline proceedings are of a generic nature. Those proceedings are looking at what is the appropriate methodology for evaluating a rate base treatment of a pipeline. The current status is called the ICC methodology, which is really a hybrid methodology involving replacement costs and as Seantor Gravel says, also it looks to historic cost base, although as far as the components that go in, the historic cost base is an evaluation methodology that has been used for gas pipelines traditionally.

So that if you have a declining curve over time, if you use a replacement cost methodology you basically get what I think Senator Gravel's assumption is, a fairly constant tariff level in real terms for the pipeline system.

If FERC were to adopt a historic cost base approach to pipeline evaluation and rate base and treatment then I think you could anticipate a substantial difference between the $6.26 or the $6.18 and Senator Gravel's amendment and whatever the pipeline would receive under historic cost base treatment.

I would like to spend some time with the Joint Committee staff but my feeling is, if FERC did take that action that we would be looking at a revenue lost of substantially more than $10 million a year.

Senator Gravel: Excuse me.

The Chairman: When you say revenue loss, hold on just a minute. Let's get this straight. You are talking here about a revenue loss but, in the last analysis, I think it is more fair to look at it on the basis of just saying that Treasury would fail to pick up a larger amount of money than otherwise it would pick up.

Here is the way I understand this thing. My mind is not closed on it at all at this moment. Here is the way that I understand it.

If the money is earned on the pipeline side, of course they pay the ordinary corporate income taxes, and so forth, as a corporation does.

They do not pay a windfall tax. But if you cut the transportation costs down, it is the same company that owns the pipeline that produces the oil, so if Alaska succeeds in cutting down the transportation costs and the Federal government is moving to cut the transportation costs, as I understand it, if the government of the United States, plus Alaska, succeeds in cutting down the transportation costs, then that shifts this money that would have been earned by the transportation company over to the producing side.

At that point, because the government wins the lawsuit, then the government applies an excess profits tax to the money that is shifted from the pipeline over to the income of the producing company.

It is all the same companies, by virtue of the shift. If you win the lawsuit, the Federal government takes all the money. At least it takes 60 percent in addition to the regular corporate income tax.

As I understand it, this does not change the estimates of revenue in the bill. The bill assumes that the case will not be won and that the transportation costs would remain the same.

If that is the case, that is what your revenue estimates are built on

Mr. Wetzler: If that assumption is wrong, then the bill will pick up more money than we thought and Senator Gravel's amendment would give back to the companies that additional revenue. But under Senator Wallop's amendment, in effect, he would terminate the tax that much sooner if we picked up more revenues.

I guess Senator Gravel's amendment would transfer money to the Alaskan producers from whoever will pay the tax, because it will take that much longer to phase out, assuming Senator Wallop's amendment passes.

Senator Gravel: The appropriate question would be, has anyone done the computations?

The Chairman: Do not count on that tax phasing out. I have seen many taxes, when it comes time to phase it out, the government needs the money so we just extend the tax. Do not count on that.

That has happened too many times around here.

At least as it stands at the moment with Mr. Wallop's amendment, theoretically that is how it would be. Alaska would pay more, therefore other taxpayers would pay more. That is how, theoretically, it works.

Mr. Wetzler: It is worse for the companies. If the tariff goes down and the wellhead value of the oil goes up because the state collects the state royalty on the wellhead type so it would collect an eighth of that increase in higher royalties.

In addition, the state levies a severance tax based on the wellhead tax and would collect another eighth of what is left in higher state severance taxes.

We would come along and collect another 60 percent of what is left in windfall tax.

Senator Gravel: That is the reason, Mr. Chairman, that I qualified it yesterday. I said that the state government has initiated this. I have opposed it because it is going to be very short-sighted because we are going to discourage -- when we find oil, we are going to discourage the economics of transporting that oil, so we are going to adversely affect our own discoveries.

The question I would ask, how much money is this going to raise nationally? When you change generic law, that now can be applied to all the oil pipeline systems in the nation and then you can now tax all of that difference.

What would happen to a line in, say, Louisiana and Texas that now has to go on a historic rather than replacement cost if that is lowered by, say, your transportation cost is 50 cents. Maybe it is lowered by 10 cents.

Then you take that 10 or 20 cents, add that into the wellhead value, tax at a 60 percent rate.

I wonder how that will be considered as newfound revenues to the Treasury.

The Chairman: Mr. Baucus?

Senator Baucus: I am wondering why the state of Alaska and the Federal government are bringing these actions before FERC. Is the reason because of the gains that the state and the Federal government will get because of the shift? Or is there some other reason?

Mr. Wetzler: There are two reasons.

The Federal government is concerned why it just so happens that the same people who produce from Prudhoe Bay own the pipeline. It may be some other producer will come in and drill elsewhere and he will not have an interest in the pipeline.

If it were not for estate taxes and Federal taxes, maybe the Prudhoe Bay producer would really not care whether they earned their money in the pipeline subsidiary or producing subsidiary if some other party comes up there and drills, someone who does not own an interest in the pipeline, drills in the Boford Sea, that producer would certainly care about how much pipeline tariff he paid.

Also, the ownership of the pipeline is not exactly the same as the ownership of the oil. There are slight differences.

The state cares because it is interested in the state royalty and state severance tax, both of which run off the wellhead price, not the transportation price, so that is the state interest.

Senator Gravel: If I might comment, I do not think I want to let that stand as it is. The state has the same reaction as any other state. Our state is just as avaricious as anybody else. If we get more money out of the oil companies, we do it, and I think that is evident by just looking on a comparative basis.

Now, do not be so nice to the Federal government. If we, as a state, are prepared to admit that we are avaricious, I think that we can lay claim to the same motivation on the Federal basis.

There are problems within the companies. This has been worked out historically. It is no big deal. It is a common carrier.

What the Federal government wants is more money and the way to go get it is to change it from a replacement cost, an historic cost. This would give them more money. It will cinch down the amount of returns or profits he will make. This is very much in vogue evidenced what we have been doing in this committee, so it is just consistent with what the government has been doing for sme time.

The Chairman: Is there any further discussion?

Senator Byrd: Mr. Chairman, if I might ask a question?

The Chairman: Senator Byrd.

Senator Byrd: Is the choice between the House proposal and the Gravel amendment, is that the choice?

Senator Gravel: No. The House proposal had the same thing as what I am suggesting plus it had something on top of that that Mr. Wetzler had developed. That was sort of indexing inflation to the whole situation. He can speak to that. That is what cost the money.

I do not want to get involved in that now, because I do not think the Committee will buy it, but I do think it will be proper to set this thing so that the Federal government will not go out an rip all of this money out from industry who is getting more than enough as it is.

The Chairman: Mr. Dole?

Senator Dole: I do not understand. I understand the Chairman's explanation and I think Senator Gravel's. If those explanations are accurate, why would the Treasury and the Energy Department oppose the amendment? Maybe there is good reason. I do not fully understand the government's argument. I know you want more money. Who reaps the windfall here, the government or the producer?

Mr. McGregor: Senator Dole, the amendment adopted in the House and the amendment to the House action on Alaskan oil only applies to production from the Sadlerochet reservoir. The administration feels that the Tier II treatment that was afforded as a result of the Committee's action yesterday is the appropriate treatment for the Sadlerochet reservoir.

There stands the rationale.

I do have a question on how Senator Gravel's amendment works because the more stringent tax treatment, even though Tier II only pplies applies to Sadlerochet, the production from Sadlerochet resevoir will start to decline sometime in the mid to late 1980's.

That means that hopefully oil from other basins, other formations such as the Boford Sea and indeed, the two known reservoirs on the North Slope right now, the Capriric and the Lisborne, will also be produced and oil will be coming into the pipeline from those reservoirs.

Does any real decline in the tariff continue to be allocated to production from the Sadlerochet, or is there an allocation between Sadlerochet production and production from other reserves?

Senator Gravel: You have not answered the question.

Mr. Wetzler: If the Committee agrees to it, we can come up with a way to draft the amendment to take care of these problems.

Senator Gravel: I do not even see what they have responded to. I think Senator Dole -- I did not understand the response. Did you?

Senator Dole: I have not understood much of anything today. That is not a requirement around here.

Senator Gravel: That is for sure.

The Chairman: Shall we vote?

Senator Dole: Is there some way to draft the amendmen to limit the revenue impact? Does that do violence to what Senator Gravel wants to do, if you limit the revenue impact to $10 million?

Mr. Wetzler: I do not think Senator Gravel cares about the first $10 million. He is concerned about the court case.

Senator Dole: That is what I thought.

Senator Gravel: You see here?

The Chairman: I would not think Alaska is such a big state that it can ignore $10 million a year. Even Louisiana can notice $10 million.

Senator Gravel: I am trying to help to Louisiana. On this one, I would be happy to contribute from Alaska $10 million to protect Louisiana.

The Chairman: I am not asking that. I am not going to get involved in all of that. Sometime you will ask me to pay it back. Let's just take Alaska.

Senator Gravel: Let me just say that the thing that I think is so serious in this case is just not the revenue of this, it is that government will alter the economics of transportation to the disadvantage of the private sector. When it does that, it will shift money that was going to energy from transportation to another part of the private sector in energy. Then it will have an excuse to tax that money in a windfall profits way.

And the case that I am making is, that has got to be the ultimate Catch-22. We come in here and say we have got to call on this revenue regardless of the fact that it is profit or not. We have to call on this revenue because the world price of oil changes and we assume, fairly or unfairly, that between what is selling now and what the price is pegged here that that is a windfall.

It is not a windfall profit. It is a windfall of something. So that they want to take that money away as a severance tax.

What they are now doing here is not applying a severance tax. They have now found a way to alter the economics of the entire energy industry in this country, and as they do that, they are going to rip out some money in the process and they are going to call that a windfall profit.

It is absolutely diabolical in its impact and I want to tell you, we are talking about generic law. When you alter generic law, it is not just Alaska that is going to be effected, it is every oil pipeline in the United States that is going to be affected, and when you do that, you are going to affect the evaluations at wellhead.

When you do that, the government now says that all of that -- and it is not just the existing reserves.

The Chairman: If anyone can cut the cost of the Alaskan pipeline, do you want to tax that with the windfall profits tax? That is all we are really talking about. The windfall profits tax is intended to apply to the windfall that results because you had a bunch of oil that is under regulation and now you are going to deregulate. And so the question is, do you want to apply that tax to the situation that exists when you cut the cost of the pipeline?

That is something that nobody contemplated, nobody thought about it, nobody had in mind at all. What do you want to do about it? Do you want to put the windfall profits tax on the Alaskan pipeline? That is about what it amounts to.

As far as I am concerned, you can put up your money and take your choice, whatever way you want to go.

If Alaska is successful in cutting the transportation costs, do you want to apply the excess profits tax to it? If you want to, vote for it. If you do not, go the other way.

Senator Gravel: I am ready to vote.

Senator Bradley: Does that apply if the pipeline is not owned by the same person as the producer?

Senator Gravel: Yes, it does.

Senator Bradley: If the producer owns the production and the pipeine, clearly if you cut the price of the pipeline, there is more profit for the producer. If the producer does not own the pipeline, does it have the same effect?

Senator Gravel: Yes.

Mr. Wetzler can add to it. What happens, you are changing generic legislation, so you are altering the economics of appraising the pipeline. So when you do that, even supposing you own a pool of oil and you hook onto the pipeline, you do not own a piece of the pipeline. You are charged a tariff. All of a sudden, your tariff goes down.

Maybe you are shipping your oil at a dollar and the tariff goes down, so now you are only paying 75 cents. That other 25 cents is not going to be added as a value to your pool of oil, so they are going to claim that that other 25 cents is a windfall. Therefore, it is taxed at 50 percent.

That is what is going to happen. It does not make any difference who owns it. It is all interchangeable, because it is a regulated tariff by the government.

The Chairman: Is this production on state-owned land or not?

Senator Gravel: Yes.

The Chairman: Is Prudhoe Bay state-owned land?

Senator Gravel: Yes.

Mr. Wetzler: The state gets one-eighth royalty.

Senator Byrd: If I may ask Treasury a question, does Treasury favor indexing pipeline tariffs?

Mr. Sunley: No.

Senator Byrd: You do not favor the House proposal?

Mr. Sunley: No. We support the Committee's action yesterday to give them upper tier treatment.

Senator Chafee: Mr. Chairman?

The Chairman: Yes, sir.

Senator Chafee: I am not sure I completely understood this, unlike others, perhaps.

If the world price is $22 and if the transportation costs are $6 currently, then the price delivered -- and then it is $16 and $13 is the upper tier level, so that the tax is on $3, is that correct?

Yes, or no?

Mr. McGregor: There is a tanker tariff component in there you have not computed.

Senator Chafee: Do not mix me up. Is that right?

Mr. Wetzler: That is right.

Senator Chafee: Let's take the situation. The world price is $22 and the pipeline drops to $4. Thus, it is now $18. $13 is the fixed price, the upper tier, and the tax applies to $5.

Mr. Wetzler: Under what you did yesterday.

Senator Chafee: Senator Gravel says that if you drop the price of the pipeline, that does not count the tax. Is it $3?

Mr. Wetzler: Under his amendment, you would raise the base price from $13 to $15 and the tax would be on $3.

Mr. Shapiro: Just the base price, by the amount of shift in the transportation costs. In your first case, where your base price was $13, you would adjust it by the $2 drop in the pipeline, so your base price in your second example would go up to $15. You would still have windfall of $3 in both examples.

Senator Chafee: I get that, but if the windfall now has gone up to $5, why is that not a windfall?

Mr. Wetzler: Senator Gravel is arguing that that $2 change in the pipeline tariff is really not a windfall. It is really a transfer from the owners of the pipeline to the owners of the oil and the same people own the pipeline as own the oil, and therefore it really is not a windfall to them, simply a transfer from the pipeline subsidiary to the producing subsidiary.

In fact, the companies lose from that change, because the state picks up 20 percent of that $2 in higher state severance taxes and higher state royalties, so the companies actually lose, but we would be increasing the windfall profits tax. That is the point Senator Gravel is making.

Senator Gravel: Would you like us to put the figures on the board?

Senator Chafee: I think I have gotten as far as I can go.

Senator Gravel: The point I was trying to make is, regardless of what is the world price of oil, it is not the change in the world price of oil that creates the windfall which is what we have all been led to believe. Now it is the actions of government which create the windfall within set figures.

Take the tariff from $6 to $4. Take that $2 that the government says is not going to be a transportation cost and you shift that over to the wellhead value that companies would be getting in their transportation revenues.

Now they would be denied that revenue. They are now going to be getting it as income at the wellhead and by changing the economics of the situation you obviously have made the pipeline transportation system less economic so supposing the government is wrong in this regard, you are taking it from a profitable enterprise to maybe a losing enterprise and you have altered their desire to go ahead and build pipeline systems later on because you have taken the money away from the wellhead and you have altered the economics of looking for oil.

If you find the oil, you have a higher transportation cost, from their point of view, for what oil is there.

Senator Chafee: What you are saying here, if you get a higher price at the wellhead through the drop of the price of the transportation cost, or what somebody says is a drop in the transportation cost, then out of that increased amount at the wellhead there is a bigger cut by the state.

Mr. Wetzler: That is right.

Senator Gravel: All the governments would benefit, because that is what they tax at the wellhead.

Senator Chafee: Plus there would be an increase in Federal income tax.

Mr. Wetzler: The Federal income tax would stay the same because the Federal government taxes the consolidated return, both the pipeline and the production. The big winner would be the state who would collect a one-eighth royalty on the additional wellhead price.

Then they would collect a severance tax of about 12 percent on that.

The Chairman: Let us get this straight now. If you do that the way I am reading this, the state would get the same amount of money anyway because the state would still --

Senator Gravel: The state gets more.

The Chairman: The state would still get -- the way the law stands today the state would still collect its severance tax. It would collect its severance tax on the amount that was paid on the oil. The state severance taxes do not allow any deduction for Federal taxes. You would still be collecting severance tax based on the entire value.

It would collect royalty based on the entire value. They would have to pay it out to the state anyway.

In any event, where the money would have to come from, it would come out of the income the companies would otherwise make.

Mr. Wetzler: Senator Gravel's amendment would not affect what the state got, but what if went down by $2 and then the wellhead price went up $2 from that change? Who would win, and who would lose?

The Chairman: The point is, if you are thinking in terms -- if you cut the transportation cost, if you are thinking in terms of where the money comes from and who was paying it, it has to be the companies who pay it. They are not paying the state of Alaska, as I understand it, the royalty or the severance tax on that transportation cost.

So when the price goes up because you cut the transportation cost, then they have to pay Alaska more money and they would have to pay the Federal government more money because of the windfall tax applied to it, because of the Gravel amendment.

Senator Gravel: There is one other feature that Senator Chafee brought to my attention when you were responding consolidated. Here is what would happen to an oil company.

Supposing it would cost $1 million to transport the oil. The government says it is too much and they have their economics set up and they are not making a profit or they are making, say, a 15 percent return. Then the government comes in and says you are charging too much. You can only charge a half a million dollars to transport that oil. That other half a million dollars now goes to the wellhead value.

The government may have made it a losing proposition to transport the oil.

The company, obviously, with its consolidated returns, will have a loss in its pipeline operations and will have normal return on its wellhead values, and then it would consolidate it together and will not pay any additional income tax and probably might have some additional deductions.

Then what the government has also done, that revenue at the wellhead is going to be less because the government has just taken a whole bunch of it with its severance tax.

So that the government, in point of fact, when you have a situation going on unrelated to the world price of oil, the government, through this device, can come in and just take, if a company is making, say, a 15 percent return on its investment could come in and probably drop at 12 percent because of this activity.

If the government views that we are picking up more revenue, but the revenue is not as a result of anyone's setting the price of oil, but because the government turned around and altered the economics of the transportation of oil.

Senator Danforth: Is it your view that is purely an arbitrary decision on the part of government?

Senator Gravel: Very capricious. What happens, as long as we have had the tax law in this area it has been on a replacement cost basis. Now the government feels it can get more money under the transportation system, so they want to alter it to historic costs, thereby, alter those economics.

After they have done that damage, they will go grab the money with the windfall profits tax.

Senator Danforth: The court decision, from your point of view, is just also -- there are no standards to government right?

Senator Gravel: None at all.

Mr. Sunley: It should be clear that the proceeding began long before the President announced the windfall profits tax, whatever motivated the Federal government to get into this issue it was not because we wanted to get additional revenue from the windfall profits tax. No one had even thought up the tax at that time.

Senator Gravel: It just wanted to get initial revenue, period. Now that the windfall profits tax has come into vogue, they now see another way to get more revenue.

The original motivation by government to lower the tariff was to be able to get more revenue. It is just that simple. It is taking it out of what is an expense area and moving it in to what conceivably could be a profit area.

Mr. Sunley: Absent a windfall profits tax the government does not get more revenue. In fact, we probably get a little less revenue if the FERC decision prevails, because, as I understand it, as Chairman Long just explained, you lower the tariff under this proceeding. State royalties go up, state severance taxes go up. State severance taxes are deductible for purposes of the income tax, and you have shifted income between the producing company and the pipeline company, but once you have put the increased income into the pipeline company, you have increased state income taxes.

Absent a windfall profits tax, this is not a money maker.

Senator Gravel: I would disagree because what you are doing is you are taking the ability away from the companies to expense an item.

When you take that ability to expense an item, you shift that to an income side of the ledger, and you take your corporate tax on that. That is not hard from that. That is really what we are talking about.

Where do you think the money comes from? By going from replacement to historic. That $2 you are shifting does not come about through magic. It is because you will not let them charge interest and other costs which they feel are legitimate and which have normally been there in pipeline transportaton systems.

So if you will not let them charge that cost to that area, you now move it to the wellhead. That is income that they cannot expense because they are already expensing their wellhead expenses, and then you are going to say that is extra income. Therefore, it is taxable. You are going to get money out of that process.

Believe me, the government does not undertake these things just for the exercise of it. If it did, it would be horrendous by itself.

Mr. Wetzler: I think the Federal government would lose revenue in the absence of a windfall profits tax, would lose revenue if the pipeline tariff went down. To the extent that the satte government wins, the additional state revenues are deductible.

Senator Gravel: What happens if an oil company is transporting oil and it owns the pipeline? It depends on what companies you are dealing with, but if you are dealing with the companies that own the line and own the oil, the Federal government is going to make money on it.

You have denied them the ability to expense items in their transportation system. That counts as income in another part of the consolidated statement, which is tax, because it cannot be offset. You cannot take the pipeline expense and move it over to the wellhead and say now we have an extra wellhead expense.

It is not there. Those things are audited.

The Chairman: Gentlemen, let me make this suggestion. We have been discussing this for a long time. As far as I am concerned, I would like to vote on the thing. Vote however you want to vote. I am not trying to persuade anybody to vote one way or the other.

But I think we can always come back and decide it again, if you think you have made a mistake. Treasury might come and talk to you about it and show you why they are right.

At some point we have to vote, even if we make a mistake.

We will try to correct it later on if we do. Sometimes we find out the vote was not even close and we have spent all morning arguing about it.

If it is all right, let's call the roll on this and see where we stand.

Mr. Stern: Mr. Talmadge?

(No response)

Mr. Stern: Mr. Ribicoff?

Senator Ribicoff: No.

Mr. Stern: Mr. Byrd?

Senator Byrd: Aye.

Mr. Stern: Mr. Nelson?

(No response)

Mr. Stern: Mr. Gravel?

Senator Gravel: Aye.

Mr. Stern: Mr. Bentsen?

Senator Bentsen: Aye.

Mr. Stern: Mr. Matsunaga?

(No response)

Mr. Stern: Mr. Moynihan?

(No response)

Mr. Stern: Mr. Baucus?

Senator Baucus: No.

Mr. Stern: Mr. Boren?

(No response)

Mr. Stern: Mr. Bradley?

Senator Bradley: No.

Mr. Stern: Mr. Dole?

(No response)

Mr. Stern: Mr. Packwood?

Senator Packwood: Aye.

Mr. Stern: Mr. Roth?

Senator Roth: Aye.

Mr. Stern: Mr. Danforth?

Senator Danforth: No.

Mr. Stern: Mr. Chafee?

Senator Chafee: No.

Mr. Stern: Mr. Heinz?

Senator Heinz: No.

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: No.

Mr. STern: Mr. Chairman?

The Chairman: Aye.

Senator Bradley: Mr. Nelson, no by proxy.

Mr. Stern: Mr. Moynihan?

Senator Moynihan: No.

Mr. Stern: Mr. Dole?

Senator Dole: Aye.

The Chairman: There are eight yeas, nine nays.

Mr. Talmadge will not present for that vote. We will see how he wants to go on that matter, and Mr. Matsunaga was not present for the vote. Mr. Boren, would you like to be recorded?

Senator Boren: Aye.

Mr. Stern: Senator Boren votes aye.

The Chairman: Let me announce this, that on the Wallop motion, the vote was 12 to 7 in favor, 12 ayes and 7 nays, and I would take it, Senator, that we will have to refine that amendment at some point. We are going to have to get some estimate as to how much we are going to collect with the taxes, otherwise you would not know where your phase out proposal would trigger. You would have to get an estimate as to how much you expect to raise over a ten-year period. Then that would have to trigger to what the phase out would be.

Senator Bradley: Mr. Chairman, it is my understanding that we have to determine at what revenue figure it phases out. That might, or might not, be the same figure that we have stated at this time we want to spend, as I understood the amendment.

Senator Wallop: As the amendment was proposed, whatever the committee has decided, how much it seeks to raise as a result of the windfall tax. That becomes a trigger.

Senator Bradley: I thought that we had agreed to set a figure after which it would phase out. That was your amendment, not that that figure would correspond to exactly what we may want to spend.

Senator Wallop: That may well be.

Senator Bradley: All right.

Senator Wallop: But they ought to be related.

The Chairman: Mr. Danforth?

Senator Danforth: Mr. Chairman, my understanding of the present status of what we have done is that we have exempted from the windfall tax, state and local governments. I am not clear as to whether or not we have exempted all local governments for all purposes, or only local governments involved in the educational enterprise.

It is my understanding that the total cost of this exemption is $6.5 billion over the period between now and 1990. I now offer an amendment that would delete that exemption and I do so for the following reasons.

That $6.5 billion revenue loss, by virtue of this exemption, has nothing whatever to do with energy. It has nothing to do with energy production or with energy conservation.

What we have been debating in this committee has to do with energy policy. As a result of decontrol of oil prices, we are going to experience a massive transfer of wealth in this country.

Basically the issue that we have been trying to resolve is what that transfer of wealth will be used for. There are those who believe that it should be put back in the ground, as they say. It should be used to drill additional oil wells and basically there are those who represent producer interests who have made that argument, and made it very well, and usually very successfully, in this committee.

There are others who believe that a very substantial portion of it should be set aside for the development of synthetic fuels. That, basically, is the administration's position. That is why the administration wants an energy trust fund.

Others say, for example, Senator Packwood, that the money should be used, the enlarged part, for various incentives, tax incentives, for conservation. All of those positions, which have been debated back and forth, have to do with the use of the increased cost of energy for either the production of additional energy or for additional methods of conservation, with the exception of this $6.5 billion.

This $6.5 billion, which is a special exemption carved out from the windfall profits tax, will not produce an additional barrel of oil, not cause the creation of an additional synthetic fuel plant, not cause an additional inch of insulation to be installed.

It has no relation whatsover to America's energy program. It is simply the carving out of an exemption which would transfer wealth from the country as a whole to certain states which happen to have -- and luckily for them -- oil within their borders.

What is not involved here is whether there is going to be a substantial increase in revenues for oil-producing states. No matter what we do, there is going to be a very significant increase in revenue for oil-producing states by virtue of increased taxes, by virtue of increased royalties received, the avaricious quality which I guess is in all of us, and which Senator Gravel was frank enough to refer to when he presented in his amendment, will be realized and there will be, according to the Joint Committee staff, additional revenues between now and 1990 of approxiamtely $60 billion going to oil-producing states. That is, governmental entities as a result of decontrol.

By abolishing this exemption, this additional revenue would be reduced to these states would be reduced from about $60 billion to about $53 billion, still a very, very subtantial increase of revenues for the states.

The purpose -- and I think the issues involved here -- are two. One is that by abolishing the exemption while still leaving the states in very good shape indeed, increased the windfall tax by $6 billion by not having any production or conservation effect. There is a second result, which I think is even more significant and which deserves special attention and that is what is involved here is really a symbolic question. It is a question as to whether America's energy policy is, indeed, a national concern, whether we, as members of the United States Senate, approach it as a national emergency, in which all Americans have a stake and to which all Americans should be expected to make sacrifices or, instead, whether the energy policy is basically a regional matter, one in which some states are going to end up on top and others are going to end up on the bottom.

I think that one of the problems we have had in trying to fashion a national energy policy over the last two years, perhaps one of the reasons that we do not have such a policy, is that we have tended to be very parochial in our interests, very anxious to take care of our own, very interested in talking about woodburning stoves in New Hampshire and talking about oil production in other parts of the country, and we have tended not to see it as a national question.

I think that it is possible in the state of Missouri, which is not an oil-producing state -- I think that it is possible to sell the issue of a national energy emergency. I think that it is possible, although very difficult, to bring the point home to people of my state.

But it is only possible if they can be convinced that the transfer of wealth that is going to accompany decontrol goes to the production or to the conservation of America's energy supply and does not go, instead, just to enriching certain parts of the country in which they do not live.

So that it seems to me, Mr. Chairman, as a matter really of national policy and, if you will, statesmanship, this amendment would be a step forward. It would not only produce an additoinal $6.5 billion of revenue between now and 1990, but it would be of enormous symbolic value in trying to give us a truly national energy program.

Seantor Bentsen: Mr. Chairman?

The Chairman: Senator Bentsen?

Senator Bentsen: Mr. Chairman, I do think that it is a very important issue and a symbolic issue and I appreciate how magnanimous my friend from Missouri can be in dividing up the people's property.

But let me say this, that what we are talking about is a state issue and a state's rights issue. If the Senator from Missouri prevails, then he will have the dubious distinction, in my opinion, of having made the breakthrough for the taxing of property, passive income, of property of states.

He has asked for an opinion of Treasury. Treasury has had this viewpoint for a long time, of trying to make the breakthrough for the Federal government to do the taxing of state property.

Frankly, if I am going to be operated on I want the knife in the hands of a friendly surgeon, and I do not think that is the case in this particular situation.

If we make this kind of an approach, that we are going to divide up other people's property, other state's property, then we go ahead and we do that also on coal. We do it on timber and we do it on shale and I do not really know where the end finally comes.

He is making the same kind of argument that the Attorney General of the United States made in the case that they are hanging their hat on generally, of New York v. the United States, but the Attorney General of the United States did not really prevail in that and they made a much narrower interpretation in that regard as expressed by Chief Justice Stone and the other three Justices that joined in that case with him.

You had four different judgments in that case, or opinions written, but in that one, Justice Stone was very explicit. They were talking about being able to tax revenue from commercial ventures. That is what this one was. This was one where they took the mineral water. They manufactured it. They took the surplus mineral water, they bottled it, they advertised it, and they carried on that kind of a commercial venture and in that kind of a case, they said it was constitutional, so you have got yourself not into just a question of dividing up other state's property. You have a serious constitutional question and I think you have a very bad public policy position if you do that, because what, in effect, you are talking about is doing some reverse revenue sharing in this country, and putting that kind of an imposition on state governments, and I think interfering in the use of revenues from state properties for the use of people for that state.

I believe that is a bad position for this country to take and I am frankly surprised to see it come from there. I would very vigorously oppose it.

You are going to find, if that position prevails -- I know this is going to be fought. Whoever wins here, it will be fought again on the Floor of the Senate; it will be fought again in conference; and if the position finally prevails, it certainly will be fought again in the courts and be fought for years to come, because you are talking about a very basic principle and that is a serious invasion of states rights by the Federal government from the taxing of property.

Royalty is property. The IRS has deemed it to be property and the trading of real estate for royalty has been deemed like for like.

Again, you are talking about something that is property and it would be a very major breakthrough and a change in the approach of Federal and state relationships.

The Chairman: I would like to be heard myself, but I will call on Senator Packwood.

Senator Packwood: Let me ask a question first. Did you say in your estimation that the New York case hinges on whether or not New York was producing the mineral waters themselves, or whether they contracted it and took a royalty?

Senator Bentsen: I think the main point -- I think they took a very narrow construction of it. I think Stone particularly did that, and they talk about the manuacturing of it, the advertising of it. It was a commercial venture.

Stone goes on to say that "we could hardly say that a general, nondiscriminatory real estate tax or an income tax could be constitutionally applied to the states, revenues from taxes, or the school lands."

Senator Packwood: Let me ask Jack a question, because I think this is a significant philosophical issue. Would this be exactly analagous to an excise tax, a windfall excise tax, if we chose to enact one uniformly on public and private land, timbers separate from state owned land in Oregon?

Senator Danforth: Would it be analagous timber?

Senator Packwood: A tax on timber. Timber has gone up tremendously in value. If we decided that was a windfall and we levied an excess tax ---a windfall profits tax, if you wanted to call it that -- on timber, would your analogy hold that you could levy the same tax on Oregon's increase in value in timber?

Senator Danforth: I could not speak for that. I am not sure about that, the factual situation in Oregon.

Basically the question here is whether a state which stands in the same position as a private royalty holder is subject to the same tax as a private entity would be. I do not think the question of a state severance tax has any relationship --

Senator Packwood: Not a state severance tax. I am phrasing it wrong. The excise tax that we are going to levy on oil in essence is the Federal severance tax, for lack of a better term, not a profits tax.

Would the analogy hold to the Federal levying of a severance tax on timber, on state-owned timber, so long as the tax was uniform or across-the-board because we thought that the profits on timber were excessive?

Senator Danforth: Yes.

Senator Packwood: Thank you.

The Chairman: Yes, sir.

Senator Roth: I think this is an important point. Are we not then saying that the Federal government has the right to tax state property, period?

The Chairman: Exactly, for a very simple reason. If you take a course in mineral law, chapter one will explain to you that minerals, particularly the irreplaceable kind, like the petrochemicals, are a part of the real estate and your tax law a trade of the mineral interests. If you are trading mineral royalties you can trade that for a piece of real estate or you can trade it for an office building and that is a tax-free exchange.

So both the state law and the Federal law regard these mineral interests as being a property and interest in property just as much as if you old somebody dirt from your property.

Let me just read to you a question that Justice Douglas asked when this New York case was before the court.

Let us look at the logic of it. Here is what he said: "If the Constitution grants a state immunity from a tax on the issue in self securities on what grounds can it be forced to pay a tax when it sells power or disposes of other natural resources?"

He is applying the analogy to the tax-exempt bonds that were, in a previous case, held to be tax-exempt. Let us ask the same question Douglas asked the other way around. If a state can be taxed on the sale of its natural resources, on what grounds can the issuance of securities be held exempt?

I asked that question of the Bankers Association in New Orleans. I must say they were very concerned about it, that if you were going to strip away the immunity that the states have had in this area, that the Treasury has, for a long time, wanted to tax the securities issued by the state government, and when you strip it down, if you can apply a Federal tax to a sale of real estate or an interest in real estate -- we are not talking about the state operating a business either, just about their selling their natural resources that cannot be replaced.

This is something that, when it is gone, it is gone. Clearly, if you can apply the tax to this sale of an interest in real estate then you can, by the same token, apply it to the sale of a state capital building itself.

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This is an interest in real estate. Now I assume the senators know something about mineral law When you take an interest in real estate, you cannot separate it.

I discussed it with a man who is a publisher of the New Orleans Times Tribune just about two days ago. What he told me would not be significant as a newspaper publisher. But that man was a great lawyer before he became a newspaper publisher. And what he told me as a lawyer, I think, is well taken. He said, "Senator, if the federal government can levy a tax on the sale of state property, I am talking about that land or their mineral interest in that land, if they can do that, then by the same token the federal government has the right to require a state government to fill out an income tax return just like a private citizen and tax it like a private citizen.

That was his opinion. That man is a good lawyer. He did not say that having done thorough research on the subject but I do not think you can separate out the sale of a mineral interest and the sale of any other interest in real estate.

I know in this case, this New York case, it was contended. Here is what happened in the lower court. The lower court said that if New York was just selling its natural resources, the lower court said, this judge said that he would not hold that New York could be taxed on the sale of that water at Saratoga Springs. But he went on to say that this was different. New York had set up a bottling plant. In fact, there had been a bottling plant there before. And they were bottling this real estate, this water. It is not an irreplaceable resource but it could be state property. But they are bottling this water and selling it.

And so the judge said in that case that in view of the fact that they had a commercial operation going on here that they would have to pay that excise tax like everybody else.

Now in that case the tax credit falls on the consumer anyway. What we are talking about here is the situation where the burden is clearly on the producer or on the seller. This is a state government selling its minerals. And in that case you have got a price dictated, you might say world market prices. And you are taxing the difference between that and what the old price was. So that the tax is clearly on the consumer. And this is clearly a tax on the state itself.

Now in the review of the cases Treasury comes up with an opinion saying that they can tax this. The government went into court against New York. And as I understand it, Mr. Hawkins read that, and he told me about it. In that case the solicitor for the government stood there and he asked the courts to hold that the federal government can tax anything New York has, any of its natural resources. Is that right, Mr. Hawkins?

Mr. Hawkins. In the original brief certain conditions in the district court the argument is in that state had said, "You cannot tax this because it is natural resources." And the district court judge said, "It is true that the tax would be bad if it were on natural resources but this is on the bottling plant.

Instead of fighting along that line, the solicitor general argued that the whole assumption. That in fact you could tax natural resources. The next thing that happened was that the court put the case down for reargument and addressed to counsel for both sides, the question of, let alone natural resources, is it not permissible to have an nondiscriminatory tax across the board so long as it does not discriminate against the state?

It is against that background that I think the Supreme Court opinions have to be read. In other words, that the government had not backed away from this natural resource point. They did not argue that this is not a -- they could have said that this is surplus water, which if you do not sell it, it is going to go into the Atlantic Ocean. So it is not like land and it is not like oil and it not like gas. So it is not a natural resource in the normal sense of these discussions.

The Chairman. I just want to make this statement. Now are you familiar with this case Group Number One Oil Company versus Bass in 1931?

Mr. Hawkins. Yes.

The Chairman. Would you explain what that case was about?

Mr. Hawkins. Group Number One was a private organization which had a mineral lease on state land. And the issue was if the federal government could tax not the royalty retained by the state, but whether it could tax the private party. In reaching the conclusion that, yes, they could tax the private party, the court dealt with the question of the state as follows, that property sold or otherwise disposed of by the government, either state or federal in order to raise revenue for government purposes, is in a broad sense a government instrumentality with respect to which neither the property itself before sale nor its sale by one government may be taxed by the other.

The Chairman. The court did not have to say that in order to reach its conclusion. But what the court said there was, yes you can tax the money that this oil company makes, but you cannot tax what the state would get for its resources.

So that at that point, that is 1931, but the court clearly came out saying, you cannot tax the state royalty. You cannot tax the state sales of its property.

Mr. Hawkins. The significance of that date, by the way, is that historically there had been an assumption that states were completely immune from federal taxation. That prior to this Group I case, prior to that it had already been held that if a state enters into a commercial business such as a liquor store that the federal government can tax that. So that quotation should be read not as something coming from the days of Chief Justice Marshall, but is coming from a time when it is recognized that if the state goes into commercial enterprise the analagous to a liquor store or a bottling plant, that the federal government can tax it.

Senator Danforth. Mr. Chairman.

The Chairman. Mr. Danforth.

Senator Danforth. I would just like to quote from New York versus United States, which is the leading case on the subject. The opinion of the court states as follows: "New York urges that in the use it is making of Saratoga Springs, it is engaged in the disposition of its natural resources. And so it is. But it is doing so, it is engaged in an enterprise in which the state sells mineral water in competition with private water, the sale of which Congress has found necessary to tap as a source of revenue for carrying on the national government.

Mr. Chairman, we can argue the law all day long. And clearly this would end up in court. It would be one of the thousands of cases every year that end up in court, maybe tens of thousands that the federal government has in court. Sure it would be.

I have the opinion of the general counsel of the Treasury that he feels it is constitutional. I also have an opinion of the Congressional Research Service. They think it is constitutional. I also have read the Supreme Court case, I think, at some point. We can go around and around on the constitutional question all day.

But I do not think this is a court of law. I think this is the place where we decide matters of public policy and national interest. And the basic question of national interest has to do with energy, and whether we as a country can come to grips with an energy program. It is not whether you are going to tax the state capitol building. That is ridiculous. And as a matter of fact this case specifically raises that question and says you cannot do it.

That is not the issue. It is not the legal issue. It is the question of whether we are all in this thing together, or instead whether this country has become vulcanized by competing interests. And all I am saying is that if, in fact, we have a national concern, an emergency situation, a situation in which foreign countries have a grip on this country, then let us face up to that as a national emergency.

Because when the Arab countries, the OPEC countries, whip us to our needs, they are not going to pick one state or another. We are all going to be on our knees together. That is the basic question before us. And I think that is the basic question we should resolve. How much energy is going to be produced by this exemption? How much energy is to be saved by this exemption? Why carve out a special place for some states? Why raise this kind of symbolic matter for the consideration of all the people of our country?

I have traveled all over my state of Missouri trying to tell people we have got a true energy crisis. And you know every place I go what they ask me? People do not want to believe it. People say, why are we shipping Alaskan oil to Japan? We are not. The people heard that we and it is the first question they want to ask because they do not want to believe that we have a national energy crisis. They want to find something else that they can talk about.

The shipment of Alaskan oil to Japan. The shipment of the people of Missouri's resources to Texas or Louisianna or Alaska. That is what they are going to be talking about. And I think that we have absolutely set up the worst kind of symbolic situation. If we are saying we are going to carve out special treatment, a special exemption, not dictated by the law, not dictated by the Supreme Court's decision, but dictated by an act of the Congress of the United States simply because we want not $53 billion over ten years but $60 billion over ten years transferred to oil producing states.

The Chairman. Mr. Roth.

Senator Roth. Mr. Chairman, I would in this sense have to respectfully disagree with my colleague from Missouri. I think that the constitutional question is an extraordinarily important one. I think it was last week we had a question as to whether or not the federal government can take certain acts in with respect to industrial or energy mobilization board.

I supported an alternate approach because I was greatly concerned that there was a serious erosion of state's rights under that proposal. If the federal government can override state and local laws whenever they find a need, that we could end up down-grading the states to where they have had no real reservation of power and authority.

The same thing bothers me here. I think that we need to review the impact on state- local conditions. I have to agree that it looks like the states that produce oil may benefit very substantially. And from that standpoint there is a great deal of appeal to it.

But I think almost importantly is the question, is the Congress going to take the point of view that the federal government has the right to tax state property? I have not read the cases. And one of the questions I would like to address the people here is have there been any careful studies of this constitutional problem beyond what we have mentioned?

The Chairman. Senator, we can provide you a great deal, both sides can, I will say. Why do you not tell him what your advice is, Mr. Shapiro. You are not a lawyer but you have had lawyers advise you. Why do you not tell me what

Senator Chafee. Mr. Chairman, who is Mr. Hawkins? I know Mr. Shapiro is going to talk next. But Mr. Hawkins gave us some more before. I am not sure, who is he?

The Chairman. He is our chief counsel. Where do you come from, Mr. Hawkins?

Mr. Hawkins. I have been in Cleveland for 25 years. And I just started here this session.

Senator Roth. One of the questions I would like to answer is that if you assume it is constitutional, then what limits are there on the federal government's power to tax the state?

The Chairman. Can you tell me, Mr. Hawkins, what position has the government taken? What position has the federal government taken with regard to its ability to tax the state government or to tax income of state governments?

We do not have to talk about an excise tax. Mr. Lubick sat right there a few days ago and said that the burden of this tax falls clearly on the government, on the state government itself if you apply this.

Now tell us what has the position of the government been with regard to its desire to tax state governments or income of state governments?

Mr. Hawkins. I believe that the position taken by the solicitor general was that you cannot have a discriminatory tax in the sense that it applies to state, or you cannot have one that is worded in a non-discriminatory manner, but because of the peculiarity of it, it really lands directly on state.

It seems to me that they show no reluctance beyond that. In other words, those are the only two tests.

There is a third one that is mentioned in the cases. And that is if -- and it is really sort of related to the second -- that if a tax should have the economic effect of wiping out a state or something, that they would recognize that as that . But it is only these very extreme tests that they were arguing for.

And I think that a significant point in the context of the Supreme Court case, I think there is a technical error in the Treasury's opinion which I think they will agree with. It refers to the language which read as being the opinion of the court. In fact there were eight justices participating in that case. And that opinion was by Frankfurter who announced the judgment of the court, that the opinion actually reflected only two justices.

And I believe you are correct. And there is no question that that quotation would support, or certainly Frankfurter's opinion as a whole would support the Treasury's memorandum in this case. But it did only reflect two out of the eight justices.

I think that the position of Frankfurter in that opinion goes almost as far as I stated. And the solicitor general, I believe, went even further.

Senator Bentsen. Let me ask, too, now as I remember reading the opinions. And I think you are right. On the quote that the Senator was giving is Frankfurter plus one justice. The Chief Justice Stone was joined by three justices, and has that not been, finally in time, been the prevailing opinion of the court?

Mr. Hawkins. I believe a later Supreme Court case did refer to that as being merely the court's opinion.

Senator Bentsen. As I recall, Commonwealth of Massachusetts versus the United States, which was 1978, in effect did that.

Can I interrupt just to correct some numbers because I know the Senator does not mean to use numbers that are not appropriate. But when we speak of $6.5 billion, that is really not correct. Because you see what has happened, we have taken out heavy oil and we talk about Treasury recovery. So the number is less than that.

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I think it is more on the order of $4.5 billion. And just so, hope I am not considered too parochial in this, I am also told by my staff that Texas's numbers for the 10 years are on the order of $125 million. We are talking about 4 percent of it in my particular state. I think it is California and Alaska that probably the ones that are most concerned as far as numbers.

Senator Danforth. Mr. Chairman, I do not know what the correct numbers are clearly, as we have gone along with this bill we have had two effects . One, we have reduced the value of the exemptions of the states. And two, we have increased the potential income for the states. So that the $6.5 billion on the value of the exemption would be reduced somewhat. So would the $60 billion total profit by the states which will be realized between now and 1990, be increased somewhat.

The Chairman. Senator, I believe you have told me about that.

Senator Danforth. Now Mr. Chairman, there is just one other point that I would like to make. And then I think I pretty well shot my wad.

The fact of the matter is that the federal government, the Congress of the United States, has control and reduced the total amount of revenues that states can realize from oil producing property. That is what the controls have done. The federal government has controlled the sale price, has controlled the royalty receipts, has controlled in fact the tax receipts that the state governments have been able to get from oil producing properties within their border.

We are doing that right now.

The Chairman. What has that got to do with the issue, Senator. You are talking about the constitutionality of it. Now you are talking about the desireability of it.

Senator Danforth. Mr. Chairman, my view is that we should not be debating the decisions because we have got opinions both ways on that. I am convinced I am right at, as a matter of law. You are convinced you are right as a matter of law. I think we should be talking about broad policies, about solving the energy problems of this country and whether that weight should fall equally or whether there should be special exemptions carved out.

But in rebuttal to my point, the question was raised that the state's rights and constitutional precedent, and I am saying that Congress has assumed much greater control and state revenues from oil producing properties through control than it every would have by virtue of doing away with this exemption.

The Chairman. Let us hear from the other senators who want to be heard. Senator Chafee.

Senator Chafee. Mr. Chairman, I just want to say that I thought Senator Danforth was very accurate in everything he said except one point where he talked of the states and local communities having to sacrifice here. This is not exactly a sacrifice. As you know, he mentioned they have been under the price controls just like everybody else has. And now the price controls are removed. They will receive a great deal more revenue than they have been receiving.

All he is saying is that they should be treated like everybody is being treated. And I do not think that is a sacrifice. Compared to their present condition, their revenues will greatly increase.

The Chairman. Senator Wallop.

Senator Wallop. Thank you, Mr. Chairman. I would like to take Senator Danforth up on this offer not to discuss the constitutionality of it and other things and just discuss the matter of equity on it. The senator says that the Congress is engaged in carving out some privilege for a few states.

I do not think Congress did that. I think if you want to look back at the foundation, God had some kind of a hand in that. He gave some other states better climates than others. And he gave some other states harbors and rivers on which they could transport goods and services. And he gave them a tax base not available to those who do not have harbors and rivers. He gave some states like Senator Packwood's, forests. He gave others whatever privileges all of us have. We are vulcanized not by the design of Congress, but by the forces of nature that go in here.

They have talked about they have already reduced the revenue of states by virtue of price control. Quite true. But they did not reduce it to the benefit of the federal government in terms

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of general revenue. They reduced it to the whole country.

There is quite a little difference in imposing a tax.

end bdm
4:35

Our contract had the Federal Government withhold a good many minerals. As a matter of fact the Federal Government in Wyoming the Federal Government controls 86 percent of the minerals of the state. The rest went either in private hands or to the state. That was the contract between the Government and the United States. That was a property we were given.

Now the Senator made the point, not today but the other day when he first brought this up. That these other states and countries have not been, that do not have oil, are getting nothing and all these other states that do have oil are getting something in exchange for nothing, some benign privilege.

I would like to point out that as far as my state is concerned what they are getting is some more oil, they are getting a tremendous amount of coal, they are getting a tremendous amount of uranium, they are getting a tremendous amount of thermal generated electricity. We have tripled our coal production. We are now the leading coal-producing state in the country. We are not the leading uranium-producing state in the country.

We have increased by 75 percent and all of this has had an enormous impact on the ability of the state to serve the people that live there and have come there to provide these privileges to the country and provide them they are. There is no question about it, that if my state was a country, we would be the eighth largest energy-producing country in the world.

But we are producing that. We have tremendous human costs.

We have people living in camps, caves and tents and have tremendous crowding. We have tremendous increase in crime and tremendous increase in the problem of delivering law enforcement in populated areas. And we use these monies to pay them. And frankly we don't fit the formulas that are devised in the Congress for most of the delivery of other human services that take place.

We were allocated last year the largest amount of money for low-income housing. The only problem was the allocation didn't work because we didn't fit any formula that was available and that money was redistributed elsewhere.

What I am saying is that this money is not some kind of windfall that is going to make big government of Wyoming extraordinarily wealthy. We are using it to take care of the rest of your energy costs.

The Chairman. Senator Bentsen, I have your name on the list.

Senator Bentsen. I made my comments concerning the amount of money that was directly involved.

Senator Packwood. I want to make sure we are talking about just an excise tax as I understand it. You were saying as a matter of energy policy we decided we wanted to put a $200.00 tax on automobiles to discourage people from driving. In your estimation, we could not put that tax on state owned cars.

Senator Danforth. What I think I am trying to do is discuss the problem rather than the law. I think that it is a matter of law of that, the all this case is about, all these opinions are about are excise tax, not property taxes or sales taxes or income taxes or anything else, just simply excise taxes and I think that that is all that involved and indiscriminately applied excise tax which is not let's say, vital state service.

I think that if you were to tax a state park, I could probably find that somewhere in that opinion or one of the other documents that I have is that that probably would be unconstitutional.

Senator Packwood. Let's go on further. We have agreed that we tax Oregon timber under this policy.

Senator Danforth. I think so, Bob, but I have not researched or even thought about all the distinctions on timber. I think that you can tax a state which essentially goes into a business which is the same as any other business if you do so on a non-discriminatory basis.

You can tax in the general tax laws unrelated business income. You can do that with respect to state governments if the tax is not only not discriminatory, but under the concurring opinion in the New York case one that does not touch the enterprise of state government.

Senator Packwood. Mr. Chairman, I will say no more. All I know is that in the dozen years I have been here we have avoided more mistakes by delay than we have solved by haste and I am not sure where to go in this. I don't know how far we can go. I don't know if you can tax the profits of Oregon's liquor stores which are a state monopoly which is an immense profit to the state. That is not an excise tax. This is the profit that the state has on the markups. It doesn't have anything to do with it but buying it. The excise tax is only levied once on the manufacturer that is the producer of it.

They mark it up tremendously and have very high liquor prices and make an immense profit that goes into the state fund and I assume under this theory that profit could be taxed and I just have some misgivings.

Senator Danforth. I don't think that is right.

Senator Packwood. What did our general counsel just say about liquor profits?

The Chairman. He said about taxing a liquor store.

Mr. Hawkins. Number one, we were just trying to keep notes about that. There is a code section which I don't think applies that might bar such a tax. They do not think it would, but that is an off-the cuff opinion.

Senator Danforth, Constitutionally that case that I mentioned back in 1905 held that the Federal Government could tax the state proceeds from a liquor store and in 1936 it came up again in reference to an Ohio liquor store, held again the tax applied.

Now the reason I am so vague in my answer --

Senator Danforth. The revenue ruling of 1971, it cannot.

Mr. Hawkins. Do you know whether that is under the state or the constitution? I mean under the code of the Constitution? There is a clear code division that limits federal income tax as it applies to state.

Senator Packwood. So now you are talking about statutory law?

Mr. Hawkins. Exactly so.

Senator Packwood. My question was, would the government have the power to tax the profits of the Oregon state liquor stores for immense profits?

Mr. Hawkins. The reason that I am a little vague is they have taxes state liquor stores in several -- the Supreme Court has upheld that several times, but I am a little vague to the exact nature of the tax.

Here it is. The first one is the liquor license tax. What about the Ohio one? There has been a series of these cases and the --

The Chairman. Senator Moynihan.

Senator Moynihan. Mr. Chairman, may I say first that I will not vote for the amendment, but in doing so, in not voting for it, I would like to make clear that I believe that Senator Danforth is absolutely right in his interpretation of the Constitution here. The federal government has the right to tax this commercial activity and I don't know that the cause was advanced by getting into litigation which I think issues have been settled for at least two generations; but I leave that aside and I don't ask anybody to respond.

I've got to tell you why I'm not going to vote for Senator Danforth's bill, although everything he said is right, in my view. Everything he said is right. I'm not going to vote for it because it would cause severe difficulties for Senators around this table who represent communities which would be affected. They would be thought not to have protected the interests of their states, and a Senator is sent here to do that. And I wouldn't want any Senator in a situation of heightened emotion to be thought that he could not protect the interests of his own people.

On the other hand, I think it behooves us to observe our behavior. We are not a random selection of the Senate. We are people in the main; we are disproportionately on this committee because of the mineral resources that our states have. And this committee has been disproportionately concerned about those mineral resources.

I don't object to concern. I am a Madisonian. I think that we are here to represent interests; but there are more interests than just the oil and gas companies of this country. And I was struck the other day when we were talking about relief for low income people as part of this package, and we had had a most attentive full audience, full attendance all through the week as we discussed stripper, and this and that, and the minerals, and suddenly we were talking about low income people, and there were five of us around the table, and only one of them, the Chairman, came from the state that had any oil or gas. And that won't work, and that had better not be the outcome of this Committee's deliberations, or it won't be accepted on the floor of the Senate and ought not to be.

But I wanted to say that I can imagine how the Senators from the states affected would feel it somehow an act not intended to be hostile, but it might be interpreted such at home, and for that reason I will not support Mr. Danforth who has the dubious consolation of knowing I agree with everything he said.

The Chairman. I was going to make a statement, but to ahead.

Senator Danforth. I am ready to vote except that I thought I would just read you my horoscope for today which says the following, "See places and people as they actually exist, not merely through a haze of wishful thinking. Be aware of the loop-holes in legal documents. Professional superior is going to make room for you."

(General laughter.)

The Chairman. I just want to briefly state a point that just occurred to me that I haven't said up to now. It will be very brief, I'll try.

One, the states are, where they have the power to do so, showing a greater interest in producing energy than does the federal government. For example, the government of Louisiana was up here just a day or so ago complaining about the fact that it's costing Louisiana $250,000 a day that the federal government won't let leases on lands that Louisiana thinks ought to be leased. Because the federal government controls those tidelands off Louisiana, they've got all kind of complaints that they can't get a lease and can't get out there to drill it, which they would if that was Louisiana's land.

I complain of this even on the land that we own. We can't get permission through federal authorities to drill it and lease it.

Now, with regard to this talk about excise tax, generally an excise tax falls on the consumer. The Secretary of Treasury was up here no later than yesterday, along with the Secretary of Energy and one of the White House advisers, to tell me that they don't want a severance tax. I was talking about phasing this tax out into a severance tax to members on this Committee. They don't want a severance tax because they feel that a severance tax, if applied to the imports as well as what we produce here, would work out to be a tax on the consumer. They want this tax because they regard this as a tax on the producer.

It's not the same as an excise tax; it is a tax on the producer. And if you can apply this type tax, which is a tax of the government itself; it is a tax of the income of that government, if you can do that, I don't see how you can distinguish any income of government. This is not a commercial operation. It's merely a case where government signs a lease to let someone go extract its minerals.

I'm ready to vote.

Mr. Stern. Mr. Talmadge.

The Chairman. No, by proxy.

Mr. Stern. Mr. Ribicoff.

Senator Ribicoff. Aye.

Mr. Stern. Mr. Byrd.

Senator Byrd. No.

Mr. Stern. Mr. Nelson.

(No response.)

Mr. Stern. Mr. Gravel.

(No response.)

Mr. Stern. Mr. Bentsen.

Senator Bentsen. No.

Mr. Stern. Mr. Matsunaga.

Senator Bentsen. No, by proxy.

Mr. Stern. Mr. Moynihan.

(No response.)

Mr. Stern. Mr. Baucus.

Senator Baucus. No.

Mr. Stern. Mr. Boren.

Senator Boren. No.

Mr. Stern. Mr. Bradley.

Senator Bradley. Aye.

Mr. Stern. Mr. Dole.

Senator Dole. No.

Mr. Stern. Mr. Packwood.

Senator Packwood. No.

Mr. Stern. Mr. Roth.

(No response.)

Mr. Stern. Mr. Danforth.

Senator Danforth. Yes.

Mr. Stern. Mr. Chafee.

Senator Chafee. Yes.

Mr. Stern. Mr. Heinz.

(No response.)

Mr. Stern. Mr. Wallop.

Senator Wallop. No.

Mr. Stern. Mr. Durenberger.

Senator Durenberger. Yes.

Mr. Stern. Mr. Chairman.

The Chairman. No.

Mr. Gravel wanted to be voted no.

Five yays and twelve noes. We'll let the absentees record themselves.

The final vote on the Alaskan pipeline is nine yays and ten nays, so the motion does not carry.

Well, we have another hearing this afternoon, do we not?

Mr. Stern. That's correct. At 2:30 on disability, Mr. Chairman.

The Chairman. So we'll meet again tomorrow at 10:00, and I would hope that the Democrats would meet with me at 9:00 here. I'd like to talk about the low income aspects of this bill, and I would hope that we can get together on something, and I'd urge our Republican members to address that question.

(Thereupon, at 12:50 p.m., the hearing was adjourned.)