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Office of the Attorney General

State of South Carolina
Opinion No. 82-13
March 10, 1982

SUBJECT: Windfall Profit Tax On Domestic Crude Oil

***1** The Windfall Profit Tax as imposed by § 4986 of the Internal Revenue Code is a tax with respect to income and thus non-deductible under § 12–7–700(4).

TO: Mr. A. B. Taylor
Director
Income Tax Division

QUESTION:

Is the Windfall Profit Tax as set forth by the Internal Revenue Code (I.R.C.) a tax on income, tax with respect to income or tax measured by income and thus not deductible in computing net income?

STATUTE:

South Carolina Code of Laws (1976), § 12–7–700(4).

DISCUSSION:

It is well settled that deductions are allowed as a matter of legislative grace, Southern Weaving Co. v. Query, 206, S. C. 307, 34 S. E. 2d 51. Thus, to avail himself of a deduction in the calculation of a tax, a taxpayer must bring himself squarely within the terms of the statute expressly authorizing it, Fennell v. South Carolina Tax Commission, 233 S. C. 43, 103 S. E. 2d 424. In addition, all ambiguity is resolved against the taxpayer. The rule generally applicable in the construction of income tax statutes that ambiguities are to be resolved in favor of the taxpayer does not apply in the construction of statute authorizing deductions. Southern Soya Corp. v. Wasson, 252 S. C. 484, 167 S. E. 2d 311 (1969). With these restraints in mind, we look to the Section in question. Section 12–7–700(4) provides for deductions in computing net income. However, it imposes limitations on certain deductions. The statute reads in part:
'In computing net income there shall be allowed as deductions: * * * (4) Taxes for the income year, except taxes on income, taxes with respect to income or taxes measured by income (other than taxes imposed by the United States on income of individuals to an amount not exceeding five hundred dollars), * * *.'

A 'windfall profit tax' on domestic crude oil was imposed by the Internal Revenue Code of 1954, hereinafter I.R.C., at 4986. The windfall profit tax is a temporary tax imposed upon a crude oil producer's windfall profit. The tax is labeled an excise tax by the Internal Revenue Code.

The question then, is whether the 'windfall profit tax' levied by the Federal Government is truly an excise tax as labeled or an income tax, a tax with respect to income or a tax measured by income. In the case of Marshall v. South Carolina Tax Commission, 178 S. C. 57, 182 S. E. 96, it was held that it makes no difference what name the legislature calls a tax or what label

is placed upon it, the character of the tax will be determined by its operation and effect. See also Reynolds v. South Carolina Tax Commission, 251 S. C. 298, 162 S. E. 2d 259. In determining the characteristic of the windfall profit tax one must first look to its legislative history and then to the actual mechanics of its computation.

Congress perceived there would be substantial windfalls from the decontrol of domestic crude oil. It was these profits it sought to tax specifically. Senate Report No. 96–394 as reproduced at 1980 United States Code Congressional and Administrative News, p. 417, provides in part:
***2** '* * * . Oil price decontrol will cause a significant increase in revenues received by oil producers and royalty owners. * * * . The committee believes that the large price increases on previously discovered oil resulting from phased decontrol are an appropriate object of taxation.'

In addition, Congress foresaw there would not be windfalls in certain areas. Thus, exemptions were carved out. This aspect of the tax is addressed in the Senate Report No. 96–394, supra, p. 418, which states:
'* * *. Thus, the windfall profit tax * * * is carefully structured to provide production incentives and to exempt categories of oil from which there are no windfalls from decontrol.'

Great care was taken to assure windfall profits only were subjected to the tax. This underlying concern is further evidenced in the computations of the tax. All taxable oil is classified into one of several 'tiers', I.R.C., § 4991. Although the tax varies according to the particular tier of oil, the structure of the tax is essentially the same, for all tiers: the tax equals the rate times the windfall profit, I.R.C., § 4987. The windfall profit is the oil's selling price minus an adjusted base price, I.R.C., § 4988. The measure of the tax is, thus, what Congress deemed the windfall profit which resulted from decontrol.

To insure the tax would not exceed the windfall profits, the tax was allowed as a deduction for, federal purposes. See Senate Report No. 96–394 supra, p. 477. To further insure windfall profits would be limited to actual profits an overall limitation was imposed. Windfall profits were limited to 90% of the producer's net income, I.R.C., § 4988(6).

Hence, the tax is imposed on profits resulting from oil released from price controls. The increase in prices and corresponding increase in profits is offset, to some degree by the new tax. Legislative history, as well as the mechanics of the taxes computation attempt to limit the taxes application to those situations where there is actually a windfall profit. In Southern Weaving Company v. Query, 206 S. C. 307, 34 S. E. 2d 51, it was held 'that the word 'income' was used in a tax statute is to be taken in its ordinary sense of gain or profit'. Thus, the windfall profit tax is clearly a tax with respect to income since it focuses on specific profits.

CONCLUSION:

The windfall profit tax is a tax with respect to income per § 12–7–700(4) and not deductible in arriving at net income.

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