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Multibillion-Dollar Tax Benefit Seen For Big Oil Firms

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The big international oil companies are getting multi-billion-dollar tax breaks as a result of the unexpected sharp increases in the price of foreign oil, a public interest tax law firm said yesterday.

The companies pay royalties, taxes or both to Middle Eastern countries mainly, for the privilege of extracting petroleum from state-owned lands.

In the past, some of the Arab countries have helped out the oil companies with U.S. tax collectors by defining the charges as the firms desired—and they could do so again, Thomas F. Field of Tax Analysts and Advocates said in a telephone interview.

Under Internal Revenue Service rulings dating back to the late 1940s, the companies have been permitted to use the royalties as dollar-for-dollar offsets against their taxes in the United States. That is, if a firm paid $1 million in royalties abroad it would be allowed to pay $1 million less in taxes here.

At the same time, the tax laws allow taxes paid to other countries by all corporations also to be credited against American taxes.

The significance of the rulings and of the laws as they apply to the international oil companies increased enormously on Dec. 23, when the principal petroleum-producing countries in the Persian Gulf increased royalties and taxes by $3.95 per barrel—from $3.05 to $7.

The "posted" price, an artificial figure used as a basis for figuring royalties and taxes, increased to $11.65 a barrel, compared with $3.01 before the outbreak of hostilities with Israel in October. Production costs are about 12 cents a barrel.

The tax benefits to the oil companies cannot be precisely estimated because of many unknowns and because their effect is complicated by other special tax provisions for the oil industry, said Field, a former Treasury Department adviser-attorney in the Office of Legislative Counsel.

But he calculated that the companies in 1974 would have to pay at least $3 billion in federal taxes if the royalties and taxes paid to the oil kingdoms were to be treated as state income taxes are treated: as deductible business expenses.

Field's calculation was made in cooperation with other former Treasury specialists.

Martin Lobel, formerly an oil industry specialist for Sen. William Proxmire (D-Wis.), recalled that a big reason for giving the oil companies tax breaks was that domestic exploration, development and refinery construction were supposed to be stimulated. But he said the reverse has happened: the stimulus has been much more effective abroad than in the United States.

Now that Arab countries have embargoed shipments to the United States and may raise prices even more, the rationale for allowing foreign tax credits to the oil companies operating in the Persian Gulf becomes highly questionable, Lobel said in an interview.

The IRS, under State Department pressure, agreed in the late 1940s to treat royalties as taxes and did so with a series of private letter rulings, tax lawyer Field said. The argument made at the time by the companies was that royalties, no matter what they were called, were truly taxes. A public ruling to this effect was issued by the IRS about 20 years ago.

Field said the IRS is empowered to order a fact-finding investigation into the extent to which the royalties are used for the same governmental purposes as taxes. The agency is also empowered to modify the ruling.

The IRS is technically free to cancel the ruling altogether. Such an effort would be vulnerable to a legal attack by the oil companies on the grounds that the ruling had acquired the force of law, Field said.

The artificial nature of "posted" prices for crude set off a clash between the IRS and the American firms operating in the Persian Gulf in the 1960s, when the agency filed a $1 billion tax lien—the largest in history—against them.

The firms were understood to include Gulf, which has a joint venture with British Petroleum in Kuwait, and the owners of the Arabian-American Oil Co. (ARAMCO): Mobil, Standard of California, Standard of New Jersey (Exxon) and Texaco.

The IRS contended the $1 billion was owed because the companies had computed the oil depletion allowance, then 27½ per cent, on inflated "posted" prices rather than on actual market prices.

Field told a congressional joint economic subcommittee two years ago that the IRS settled for 50 cents on the dollar. The agency says it is not permitted to discuss such negotiations involving any taxpayer.

In a related matter, Sen. Proxmire has been unable for four years to get the IRS to act on his request that it revoke a ruling which, Field says, has benefited only the owners of ARAMCO and BP's partner in Kuwait, Gulf.

The ruling, issued in 1956, made an exception to a 1954 regulation that prohibits corporations with a subsidiary enjoying a depletion allowance to pass the subsidiary's savings through to stockholders. The savings from the ruling are unknown.

Proxmire in February, 1970, asked the IRS to revoke the ruling on the grounds that it was inconsistent with the regulations. "A study has been initiated," the agency replied in April, 1970.

In September, 1971, Proxmire asked for a status report. The study is under "active consideration," Assistant Commissioner Harold Swartz replied two months later. "Every effort is being made to bring the study to an early conclusion."

In 1972, Gulf paid the lowest rate of federal taxes on net income before taxes, 1.2 per cent. Mobil paid 1.3 per cent, Exxon 6.5, Texaco 1.7, and Standard of California, 2.05.