

# IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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## HOW TO NOT ATTAIN ENERGY SECURITY

A *bill of attainder* is a legislative act that singles out an individual or group for punishment for some purported crime without a trial.

The Constitution of the United States, Article 1, Section 9, paragraph 3, declares: "No Bill of Attainder or ex post facto Law shall be passed."

The use of bills of attainder by the monarchies of Europe to punish their opponents so offended the Founding Fathers that they wrote a prohibition against such despotic practices into the Constitution. That, of course, has never been the end of the matter.

In November, 2005, the CEO's of the five largest oil companies selling fuel in the United States appeared before a joint hearing of the Senate Energy and Natural Resources Committee and the Senate Committee on Commerce, Science, and Transportation on the rise in fuel prices following Hurricanes Katrina and Rita. The witnesses' testimony and their responses to questions could have come directly out of any principles of economics textbook, pointing out that a reduction in supply must cause an increase in price of any commodity if the market is to work to allocate the remaining product in an efficient manner.

The witnesses, however, were not cast in the role of teachers speaking to interested students, nor was the setting that of a classroom. Rather, it more closely resembled a courtroom, with some of the Senators accusing the witnesses of economic crimes or, at least, bad behavior. Executives of the same companies were called back to testify before the

Senate Judiciary Committee in March, 2006, along with the head of a major refining company. They were again subjected to a series of questions that were more in the nature of accusations than a search for information. Another witness, an independent economist, largely supported the companies' contention that the price increases were related to the world price of oil and gas, not to evil-doings in the executive suites.

Although the hearings were not real trials, there was a real verdict. The witnesses were found guilty of presenting an economic explanation of their actions instead of offering a full confession of their political crimes and misdemeanors. There was also a real sentence in the form of three peculiar tax provisions in the Senate version of the Tax Reconciliation bill which singled out the group of five integrated oil companies represented at the hearings.

These punitive provisions involve, for the five big firms only, an arbitrary change in the accounting for crude oil and refined fuels inventories that would inflate taxable income, and an unfavorable alteration in the write-off periods of certain exploration and development costs. For the three firms that are headquartered in the United States, a third provision would curtail access to the foreign tax credit for taxes paid abroad by means of redefining what sort of foreign payments qualify as taxes for the purpose of the credit. (The other two firms are subsidiaries of foreign companies, and would not feel this provision.) Other U.S. energy sector businesses would not be affected by these measures, even though the companies may also have experienced

significant inventory or other profit increases in the fourth quarter of 2005, in some cases representing even higher spikes in rates of return than for the major integrated firms (whose returns on capital have been only average or worse over the last 25 years). (For a fuller discussion of the provisions, see Michael Schuyler, "Senate Tax Provisions Fuel Controversy," *IRET Congressional Advisory*, No. 199, March 2, 2006, available at <ftp://ftp.iret.org/pub/ADVS-199.PDF>.)

Of course, the tax provisions in the Senate bill are not strictly a bill of attainder. They only egregiously violate the spirit, not the letter of the Constitution. That is not because the "personhood" of corporations under the law is a legal fiction; a corporation is very much a group of persons, called "shareholders". Rather, it is because the Senate may claim that the punishment is not punishment at all, just a shift in tax policy, a shift so narrowly defined that it just happens to affect only the offending parties.

The Senate action brings to mind the "Wal-Mart" bill on minimum outlays for health insurance enacted this year by the Maryland legislature. That body apparently felt that Wal-Mart employees should get more of their compensation in expanded health coverage and less in cash wages whether they wanted it or not, so the legislature mandated a health insurance package for firms with a certain number of employees in Maryland that just happened to affect only Wal-Mart. How grand it is that our federal system not only allows the states to be laboratories for innovative policies that can subsequently inform

federal practice, but that federal practice can inspire state-level innovation as well.

The likely consequences of the Senate provisions would be: energy firms would anticipate lower returns on the holding of inventories in the future, and would hold smaller inventories. In the event of another interruption of production and refinery activity, the country would run out of inventory sooner, and be forced to turn to imports sooner, than under current law. Much of the replacement supplies would have to be purchased from companies headquartered in other nations which may be required by their home countries to put foreign consumers ahead of consumers in the United States.

U.S. headquartered firms would face higher costs of exploration and development of all energy properties, and will be constrained in how much they can bid to acquire new reserves abroad. They would have reduced shares in foreign ventures, and reduced access to foreign supplies.

The Senate energy taxes would not attain access to more energy for the country, would not lower prices, and would not enhance energy security. They would do just the opposite. They are bad tax policy and bad energy policy. They are also bad law. It is to be hoped that the conference committee reconciling the House and Senate tax bills will omit them.

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