Windfall Tax

Why in news?

Against the backdrop of rising crude oil prices due to Russia's invasion of Ukraine, there has been a buzz in markets about a one-time windfall tax on oil and gas companies.

What is a windfall tax?

- When a company benefits from something that they are not responsible for, the financial gain that ensues is called windfall profits.
- Governments, typically, levy a one-time tax over and above the normal rates of tax on such profits and that is called windfall tax.
- Since, energy companies are gaining profit not because of any improvement in their processes but because of the geopolitical situation, many governments are considering to impose such tax.
- This will boost the government's finances, and help fund efforts to protect vulnerable sections from rampant inflation.

Which countries have imposed such taxes?

- Italy and the UK are two key economies that have levied windfall tax.
- **Italy's case**- Italy announced taxing the profits of energy companies at 25% to help fund a support package for consumers and businesses that have been hard-hit by soaring energy costs.
- **UK's case**- UK will increase the headline rate of tax on those profits to 65 % from 40% to profits arising on or after May 26, 2022.
- A Bill is being introduced for an 'Energy Profits Levy' and it will also include a sunset clause, which will remove the tax after 2025.

What is the case with India?

- The public expenditure on fuel, food and fertiliser subsidies are ballooning amid skyrocketing inflation.
- The FY23 fertiliser subsidy budget estimate is Rs 1.05 trillion.
- Oil and Natural Gas Corporation (ONGC) and Oil India Ltd (OIL) reported bumper profits in the March quarter and record earnings in 2021-22.

What has to be well thought before imposing windfall tax?

- **Compromise on profits**- The first consideration by the government to impose windfall tax will be the production sharing contracts (PSCs).
- PSCs are long term contracts where the government is also a party and when the prices go up, the government also stands to profit.
- So, the government has to compromise on dividends and share buybacks, both of which the

centre is a beneficiary of.

- **Royalties**- The second consideration is the royalties and ad valorem duties.
- **Investor confidence**- If such changes are made to the taxation policy, the government will have to consider what signal this will send out to the foreign investors under the FDI policy.

What are the criticisms against imposing windfall tax?

- The one-off taxes, which by definition are imposed retrospectively, are seen as arbitrary, fueling uncertainty among businesses about future taxes.
- The imposition of windfall tax is branded as anti-investment and anti-business.

References

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