

## Windfall Profits [UPSC Economy Notes]

The Central government increased the windfall profit tax imposed on domestically produced crude oil and on the export of diesel and aviation turbine fuel (ATF) in February 2023. In this context, it is important to understand what is the meaning of windfall profit. What does taxing windfall profits mean? Read on to know more about this concept for the [IAS exam](#) economy section.

### What is Windfall Profit Tax?

Windfall profits are an unexpected rise in profits of a company as a consequence of an external incident which might be due to long-term or short-term reasons and not because of a business decision. A tax imposed on such an unanticipated rise in profits is called a windfall profit tax.

### Why are Windfall Taxes imposed?

According to the 'Financial Situation of Oil Companies' report by the B.K. Chaturvedi Committee (2008), taxing these unforeseen profits had been considered an exclusive right of the government, both to fund fiscal needs and to carry on redistributive justice.

- The primary objective of windfall tax is to take advantage of the high profits made by the oil companies and use it for the nation's local needs.
  - For instance, windfall taxes could be used to enhance tax collection to offset the outcome of a larger geopolitical event or redistribute them and use it for countries' social welfare schemes.

### Windfall Taxes Latest News

The Centre has announced a reduction of special additional excise duty, or windfall tax, on domestically produced crude oil to nil from Rs 3,500 per tonne, effective from April 4.

- The government has also reduced the levy on diesel to 50 paise per litre from Rs 1.
- This move is expected to provide relief to major fuel exporters like Reliance Industries and oil explorers like ONGC.

### Reasons for the Reduction in Windfall Tax:

- The decision to reduce windfall tax on domestically produced crude oil has been taken after a detailed review of global crude oil prices.

- According to a government official, tax rates are reviewed every fortnight based on average oil prices in the previous two weeks.
- The government aims to encourage higher domestic production of crude oil, which has been a key focus area.

#### **Implications for Indian Oil Companies:**

- Indian oil companies are expected to benefit from the reduction in windfall tax. The move is likely to incentivize domestic production of crude oil, which will help the country meet the rising demand for hydrocarbons.
- The government has been making a series of policy changes to encourage more domestic production of crude oil.
- In the last review, the levy on domestic crude oil was reduced from Rs 4,400 per tonne to Rs 3,500.
- However, the official indicated that the levy may come back if global prices remained elevated over the next few weeks.
- Brent crude oil prices rose to \$84 per barrel after the [OPEC+](#) group announced a sudden production cut over the weekend.
- India first imposed a windfall profit tax in July 2022, joining a growing number of nations that taxed super-normal profits of energy companies.

#### **Conclusion:**

- The reduction in windfall tax on domestically produced crude oil is a positive development for Indian oil companies.
- It is likely to incentivize more domestic production of crude oil and help the country meet the rising demand for hydrocarbons.
- However, the levy may come back if global prices remain elevated over the next few weeks.

#### **Reasons for Windfall Gains**

- **Attack on Ukraine by Russia:**
  - Russia was one of the biggest producers in the world oil market along with the United States and Saudi Arabia. As a retaliation to [Russia's attack on Ukraine](#), many Western countries decided to stop their energy imports from Russia.

- This caused a sharp rise in fossil fuel prices as countries now started searching for other suppliers for their energy needs. This led to an increase in profits for oil companies.
  - According to a Reuters report, all big oil companies like Shell, Chevron, BP and Total Energies together doubled their profits to \$219 billion in the year 2022.

### Issues with imposing windfall taxes

- **Creates uncertainty in the market:** Experts believe that investors invest in a sector based on the certainty and stability of a tax regime. Windfall taxes can bring about uncertainty and instability in the market since they are imposed retrospectively and are influenced by unanticipated events.
- **Windfall taxes are being criticised as populist and politically opportune in the short term:** Introducing a temporary windfall profit tax reduces future investment.
- **Lack of definition:** It is difficult to determine what exactly qualifies as actual windfall profits and to decide if a certain level of profit is normal or excessive.