



Windfall Tax

For Prelims: Windfall Tax, Russia-Ukraine Conflict, Covid-19, fiscal Policy.

For Mains: Rationale and Issues Related to Windfall Tax.

Why in News?

Recently, the Ministry of Finance has justified the **imposition of [Windfall Tax](#)** on domestic **[crude oil](#)** producers in July 2022, saying that it was **not an ad hoc (made or done suddenly) move** but was done after full consultation with the industry.

- Besides India, a wave of countries including the United Kingdom, Italy, and Germany have either already imposed a windfall profit tax on **super normal profits of energy companies or are contemplating doing so.**

What is a Windfall Tax?

- **About:**
 - Windfall taxes are **designed to tax the profits a company derives** from an external, sometimes unprecedented event— for instance, the **energy price-rise as a result of the Russia-Ukraine conflict.**
 - These are profits that cannot be attributed to something the firm actively did, like an investment strategy or an expansion of business.
 - A windfall is defined as **an “unearned, unanticipated gain in income** through no additional effort or expense”.
 - Governments typically levy a **one-off tax retrospectively over and above the normal rates of tax** on such profits, called **windfall tax.**
 - One area where such taxes have **routinely been discussed is oil markets**, where price fluctuation leads to **volatile or erratic profits for the industry.**
- **Rationale:**
 - There have been varying rationales for governments worldwide to introduce windfall taxes, from **redistribution of unexpected gains when high prices benefit producers at the expense of consumers**, to funding social welfare schemes, and as a **supplementary revenue stream** for the government.

Why are Countries Levying Windfall Taxes Now?

- Prices of oil, **[gas](#)**, and **[coal](#)** have seen sharp **increases since late last year** and in the first two quarters of the current year, **although they have reduced recently.**
- The increase stems from a combination of factors, **including a mismatch between energy demand and supply** during the economic recovery from **[Covid-19](#)**, further amplified by the **[Russian war in Ukraine](#).**
- Pandemic recovery and supply issues resulting from the Russia-Ukraine conflict shore up energy demands, **in turn driving up global prices.**

- The rising prices meant huge and record profits for energy companies while **resulting in hefty gas and electricity bills for household bills** in major and smaller economies.
- The levies came as refiners made major gains by **boosting fuel exports to countries that were in a deficit like Europe**, which has now boycotted oil imports from Russia.
- The [U.N.\(United Nations\)](#) chief urged all **governments to tax these excessive profits** “and use the funds to support the **most vulnerable people** through these difficult times.”
- The calls to introduce windfall taxes also found support in organisations like the IMF, which released an **advice note as to how such a tax should be levied**.

What are the Issues with Imposing Windfall Tax?

- **Uncertainty in the Market:**
 - Companies are confident in investing in a sector if there is **certainty and stability in a tax regime**.
 - Since windfall taxes are imposed retrospectively and are often influenced by unexpected events, they **can brew uncertainty in the market** about future taxes.
- **Populist in Nature:**
 - It is believed that such taxes are [populist](#) and politically opportune in the short term.
- **Reduces Future Investment:**
 - Introducing a temporary windfall profit tax **reduces future investment because prospective investors will internalize** the likelihood of potential taxes when making investment decisions.
- **Not Defined Precisely:**
 - It is not defined **what exactly constitutes true windfall profits and how it can be determined** what level of profit is normal or excessive.
 - If rapid increases in prices lead to higher profits, in one sense it can be called true windfalls as they are unforeseeable but it can be argued that it is the profit **the companies earned as a reward for the industries risk-taking** to provide the final product to the end user.
 - It is not defined who should be taxed- only the big companies responsible for the bulk of high-priced sales or smaller companies as well— raising the question of whether producers with revenues or **profits below a certain threshold should be exempt**.

UPSC Civil Services, Previous Year Questions (PYQ)

Q. Explain the salient features of the Constitution (One Hundred and First Amendment) Act, 2016. Do you think it is efficacious enough “to remove cascading effect of taxes and provide for common national market for goods and services”? **(2017)**

[Source: TH](#)

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