Oil Windfall Tax: Should Canadian Energy Investors Worry?

Description

The U.K. and a number of other European countries are imposing windfall taxes on oil and gas companies to help reduce the impact of higher energy prices, as citizens struggle with rising inflation. Canadian energy investors are wondering if the same approach is on the way in Canada.

Oil and gas windfall tax

The United Kingdom is hitting oil and gas companies with a 25% windfall tax. The idea is to redistribute the money to families that are being hit the hardest by rising energy prices. The U.K., as well as other European countries, have been hammered by soaring natural gas, gasoline, and diesel fuel prices over the past two years.

Natural gas prices are much higher in Europe than in North America. Homes and businesses rely on the fuel to heat water, keep the building warm, and cook food. The war in Ukraine has made the problem even worse, and governments are scrambling to find solutions.

Across the pond, reports have surfaced that the American government is considering a similar tax. Natural gas prices have soared in the domestic market along with gasoline prices. High gas prices are bad news for politicians, and it wouldn't be a surprise to see some form of a windfall tax emerge in the United States, especially with mid-term elections coming up later this year.

In Canada, the situation is more complicated. Any attempt by the federal government to single out the energy companies the way it hit the banks earlier this year would trigger a political firestorm. Taxing big banks based in Ontario is an easy sell to the Canadian public. Targeting western Canadian oil and gas producers who are just getting back on their feet after years of tough times would be much harder to pull off and is politically risky. In addition, provinces have authority over their non-renewable resources under the terms of the Canadian constitution, so there would be jurisdiction challenges to any proposed windfall tax on the energy sector.

Canadians are being hit hard with higher fuel prices, but the federal government is also already reaping a big tax windfall on soaring profits in the energy sector. Additional tax credits for low-income families might get announced to help offset rising energy prices, but a windfall tax directed at energy companies, similar to the one levied on the banks, is unlikely.

That being said, governments don't always act as one might expect.

Should you buy Canadian oil and gas stocks now?

At the time of writing, WTI oil trades near US$120 per barrel. This is a very profitable level for oil producers and the state of the global oil market is probably going to remain in a situation of tight supply for the next few years. Oil stocks have soared in the past two years, but most still appear undervalued based on future earnings expectations at current oil prices. **Suncor Energy** (TSX:SU)(NYSE:SU), for example, trades near $53 per share today. It was $44 before the pandemic when WTI oil was US$60 per barrel.

Volatility should be expected, but investors who are underweight energy stocks in their portfolios might want to consider adding Canadian producers to their holdings today.

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