Vanderbilt Law Review

Volume 36
Issue 1 *Issue 1 - January 1983*

Article 3

1-1983

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Recommended Citation
Nancy E. Shurtz, State Taxation of Energy Resources: Are Consuming States Getting Burned?, 36 *Vanderbilt Law Review* 55 (1983)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol36/iss1/3

State Taxation of Energy Resources: Are Consuming States Getting Burned?

*Nancy E. Shurtz**

The Arab oil embargo of 1973 and the severe energy shortage it caused in the United States prompted federal authorities to formulate a national energy policy that would encourage exploitation of domestic energy resources. As the federal government has implemented this energy policy, states rich in natural resources have begun to tax the energy mining and production operations within their borders. In this Article Professor Shurtz discusses the constitutional limits of this taxation and examines how the revenues from these taxes alter the balance of wealth between energy-producing and energy-consuming states. Professor Shurtz concludes that revisions in revenue sharing formulae, limitations on energy taxes agreed upon in a multistate compact, and efforts to make states energy independent should be explored as possible solutions to avoid a potential energy conflict between the states.

I. Introduction

During the Arab oil embargo of 1973 the United States was for the first time confronted with a severe energy shortage. The nation suddenly found itself unprepared to deal with the many economic disruptions initiated by the abrupt curtailment of foreign oil supplies. To counteract the effects of any future cutbacks by the Organization of Petroleum Exporting Countries (OPEC), the federal government attempted to formulate a national energy policy that would reduce the country's dependence on imported oil. Federal authorities began to implement this policy in hopes of promoting conservation, encouraging the use of domestic energy resources, and fostering the development of alternate energy sources.[1] Although this policy has met with relative success in in-

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1. Congress and state legislatures adopted a variety of measures to accomplish these objectives. One of the first federal statutes, the Natural Gas Policy Act of 1978, Pub. L. No.

creasing domestic energy supplies,[2] the Reagan Administration has not supported the continued growth of these programs.[3] On the contrary, the current administration has pledged to reduce the federal presence in energy conservation and production.[4]

As the federal government has diminished its presence in the administration and direction of the energy industry, new regional

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95-621, 92 Stat. 3350 (1978), called for the gradual deregulation of natural gas prices. In 1979 President Carter initiated decontrol of oil prices through the Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627 (1973), and the Energy Policy and Conservation Act, Pub. L. No. 94-163, 89 Stat. 871 (1975). The theory underlying deregulation was to allow the prices of American oil and gas to reach worldwide levels to provide domestic oil producers with financial incentives to develop further America's energy resources, and, thus, to reduce the nation's dependence on foreign oil.

In 1980 Congress adopted the Energy Security Act, Pub. L. No. 96-294, 94 Stat. 611 (1980), which created the United States Synfuels Corporation and provided numerous price and loan subsidies for the development of alternative energy resources. The Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 (1978), and the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 (1980), (Windfall Profit Tax), established credits and other tax incentives for conservation and the development of renewable energy sources such as solar, water, wind, geothermal, ocean thermal, wood, hydroelectric, and biomass, as well as nonrenewable energy sources, including petroluem coke, coke gas, pitch, oil, and synthetic fuels.

The Windfall Profit Tax also imposed an excise tax on the producer of oil based on the difference between the "removal price" and the "base price" of the oil. The removal price is usually the price at which the oil is sold to a third party purchaser. If the oil is removed before sale, transferred to a related party, or refined by an integrated company, then the removal price is the constructive sale price, as determined in § 163 of the Windfall Profit Tax Act. The base price of oil depends on the type of oil being sold. The base price of Tier 1 oil is the price at which the oil sold under the 1979 energy price controls. The base prices of Tier 2 and Tier 3 oil fluctuate, depending on the grade, quality, and location of the oil. The tax rate also varied depending on the type of oil being produced.

At the time of adoption of the Windfall Profit Tax federal officials estimated that revenues from the tax would be $270 billion over a ten-year period—a portion of which would be earmarked for energy programs. *See* Shurtz, *The Windfall Profits Tax—Poor Tax Policy? Poor Energy Policy?*, 34 U. MIAMI L. REV. 1115, 1136-39 (1980).

2. The increase in tax revenues from energy-related taxes in energy producing states reflects the success of the energy production incentives. *See infra* note 5 and accompanying text.

3. For example, the current administration has declined to fund the programs established by the Energy Security Act, Pub. L. No. 96-294, 94 Stat. 611 (1980). Similarly, the administration has recommended eliminating the energy tax incentives and dismantling the Department of Energy Office of Alcohol Fuels. U.S. DEP'T OF ENERGY, QUARTERLY REPORT TO THE PRESIDENT AND CONGRESS, at 2, 3 (Apr.-June 1981); *see* Shurtz, *Promoting Alcohol Fuels Production: Tax Expenditures? Direct Expenditures? No Expenditures?* 36 Sw. L.J. 597, 639-40 nn. 362, 364 (1982).

4. For example, the Reagan Administration has allowed the expiration of the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. § 760g (1976 & Supp. IV 1980), which imposed ceiling prices on domestic crude oil sales. Further, § 602 of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 337-38, reduces the tax created by the Windfall Profit Tax on newly discovered oil from 30% of the so-called "windfall profit" to 15% by 1986.

energy problems, resulting largely from the relationship of the energy-producing states to the energy-consuming states, have arisen. As a result of production incentives, states rich in oil, gas, and coal resources have been able to generate huge revenues from energy resources on their land or on federal land within their borders.[5] Of all the state revenue sources that affect the energy industry,[6] taxation schemes remain the most controversial with regard to the relationship between energy-producing and consuming states.[7] By taxing their energy resources producing states potentially can export their tax burden to the consuming midwestern and northeastern states.[8] Over the last five years both the rates and types of natural resources taxation schemes have increased dramatically.[9] Even en-

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5. The large increases in producing states' revenues between fiscal 1979 and fiscal 1981 reflect the effects of oil price decontrol. *See* P. Mieszkowski & E. Toder, Taxation of Energy Resources: Implications for Intergovernmental Relations and Economic Efficiency, (1981) (unpublished paper).

6. States can generate revenue from energy resources in three ways: (1) state taxes derived from the mining and exploitation of resources, *see infra* part II; (2) rents or royalties collected from the enterprise that extracts the energy source; and (3) production and marketing of energy resources by the states themselves.

While state taxation schemes are the topic of this Article, the collection of rents and royalties by producing states amounts to a significant source of revenue. State receipts from mineral leases have grown from approximately $.5 billion in 1972 to $3.3 billion in fiscal 1980. Eighty percent of these receipts are from activities on state-owned land. The remainder are from lease receipts shared with the federal government. *See* P. Cuciti, H. Galper, & R. Lucke, *State Energy Revenues: A Potential Intergovernmental Problem,* in 1981 ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS.

States also receive royalties from minerals and energy produced on federally-owned lands within their boundaries. The minimum federal royalty is 12.5% of the amount or value of the mineral removed. 30 U.S.C. 226(c) (1976). Fifty percent of federal royalties are allocated to the states. In fiscal 1978 states received $228 million in royalties from energy produced on federally-owned land. P. Mieszkowski & E. Toder, *supra* note 5, at 18-19.

7. The potential receipts are enormous. By 1990 Wyoming is expected to collect a surplus of $350 million per year from coal severance taxes. *See* Transcript from the MacNeil/Lehrer Report, Energy Civil War, at 2 (August 29, 1980).

8. *See* C. McClure, Tax Exporting and the Commerce Clause: Reflections on *Commonwealth Edison* (1981) (unpublished paper) [hereinafter cited as C. McClure, Tax Exporting]. McClure suggests that the extent of the tax export depends upon four considerations—the market position of the state, the mobility of the taxed activity, the ability to substitute a product for the taxed product, and the elasticity of demand. McClure, *The Interstate Exporting of State and Local Taxes: Estimates for 1962,* 20 NAT'L TAX J. 49, 56-57 & n.27 (1967) [hereinafter cited as McClure, *Interstate Exporting*]. McClure submits that although taxes generally are not susceptible to total exportation, McClure, *Economic Constraints on State and Local Taxation of Energy Resources,* 31 NAT'L TAX J. 257, 259 (1978), a mineral severance tax is an exception if demand for the mineral is highly inelastic and if the taxing state dominates the supply. McClure, *Interstate Exporting, supra,* at 59.

9. New Mexico increased the rate of its severance tax three times in 1980. *See* N.M. STAT. ANN. § 7-26-1 to -11 (1980 & Supp. 1982). In 1975 Montana increased its severance tax on surface mined coal from $.34 per ton to 30% of the contract sales price less any produc-

ergy-consuming states have attempted to reap the benefit from these energy revenues by taxing oil companies.[10] These taxing schemes have resulted in a substantial wealth transfer from the energy-poor states to the energy-rich states as well as the potential for significant tax exportation by the producing states.

This Article examines the use of state energy taxes and the widening economic disparity between energy-producing and consuming states. In addressing these newly developing regional energy problems, part II of the Article discusses the specific types of taxes levied on energy resources and the impact of these taxes on energy producers and consumers. Part III of the Article discusses the potential constitutional problems in state taxation of energy resources in the context of the commerce, equal protection, due process, privileges and immunities, and supremacy clauses. Finally, part IV of the Article explores possible solutions to reduce the financial disparities between energy-producing and energy-consuming states, federal intervention in state tax schemes, cooperation between the states, a federal revenue sharing program to benefit energy consuming states, and energy independence for consuming states.

II. Description And Effect Of State Taxes On Energy Resources

A. *Severance Tax*

A severance tax is an excise tax levied on the amount of a natural resource extracted from the lands and waters within a state's jurisdiction, including federal lands within a state. The actual tax levied by the state may bear a variety of names—license tax, conservation tax, production tax—but each is a tax on the extraction of resources from the ground.[11] A severance tax, unlike a specific user tax,[12] is not designed to be a *quid pro quo* for a particular benefit or service rendered by the state. Rather, it is a general rev-

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tion taxes the seller passed on to the buyer—an effective rate of approximately 21% or $2.05 per ton at 1979 prices. Wyoming followed with tax hikes in 1975 and 1977 te a statutory rate of 10.5%—approximately $1.02 per ton. P. Cuciti, H. Galper & R. Lucke, *supra* note 6, at 7.

For a description of various taxing schemes, see *infra* Part II.

10. *See infra* notes 254-66 and accompanying text.

11. *See Severance, Production Taxes*, 2 St. Tax Guide (CCH) ¶ 45-000 (Jan. 1979).

12. Specific user taxes, such as highway use taxes, are not revenue measures, but rather charges or rentals for tbe use of a public facility. P. Hartman, Federal Limitations on State and Local Taxation § 2:6, at 31 (1981).

enue tax that is used not for any specific end, but to defer the overall social, environmental, and economic costs associated with producing that natural resource.[13] A severance tax is usually ad valorem—based on the value of the product—but it may also be specific—based on the units of production.[14] The tax is imposed on the extraction of natural resources in the state, regardless of whether the resources are shipped out of the state or whether the firm extracting the resource is local or interstate. In most cases, however, the burden or incidence of the tax is borne by out-of-state residents because most of the natural resource is exported out of the taxing state.[15] Economic studies have shown that the degree of exporting depends upon the monopolistic power of the state, the extent of the cartelization by the producing states, the mobility of various resources, international competition, natural substitutability, government regulations, the prevalence of long-term contracts, and transportation costs.[16]

States usually impose severance taxes, but local governments also can impose them. In addition, Indian tribes have jurisdiction to impose severance taxes on resources extracted from their territories.[17] Michigan imposed the first severance tax in 1846.[18] By 1982 thirty-three states had adopted some type of severance tax.[19]

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13. Recently, states have placed large amounts of this revenue in trust funds. For example, under the terms of a recent amendment to the Montana Constitution, at least 50% of the revenues generated by mineral severance taxes must be paid into a permanent trust fund. The principal of the fund may be appropriated only by a vote of three-fourths of the members of each house of the legislature. MONT. CONST. art. IX, § 5. One can argue that a payment to this trust fund is to cover the cost of depleting a nonrenewable energy resource—perhaps a user fee. *See supra* note 12.

14. *See, Severance, Production Taxes,* ST. TAX GUIDE (CCH) ¶¶ 45-200 to -951 (Mar. 1982). Examples of states using this specific method include Louisiana, LA. REV. STAT. ANN. § 47.633 (West 1970); Montana, MONT. CODE ANN. §§ 15-36-101, -103 (1977); and Wyoming, WYO. STAT. § 39-6-302 (1977 & Supp. 1981).

15. *See* C. McClure, Tax Exporting, *supra* note 8, at 7.

16. *See supra* note 8.

17. The Indian Reorganization Act of 1934 § 16, 25 U.S.C. § 476 (1963), authorizes any tribe residing on a reservation to adopt a constitution and bylaws subject to the approval of the Secretary of the Interior. In Merrion v. Jicarilla Apache Tribe, 102 S. Ct. 379 (1982), the Court upheld a severance tax levied by the tribe and authorized in the tribe's constitution. *See also* Crow Tribe of Indians v. Montana, 650 F.2d 1104 (9tb Cir. 1981), *cert. denied,* 103 S. Ct. 230 (1982) (court held on the facts that a state cannot tax extraction on Indian lands when it conficts with a tribal severance tax).

18. T. Stinson, State Taxation of Mineral Deposits and Production, at 6 (U.S. Dep't. of Agriculture—U.S. Envtl. Protection Agency 1977).

19. Statement of Shirley Kallek, Associate Director for Economic Fields, Bureau of the Census, Department of Commerce, before the Senate Intergovernmental Relations Subcommittee on the Commerce Clause and Severance Taxes, at 1 (July 15, 1981) [hereinafter cited as Statement of S. Kallek].

Severance taxes are imposed on resources such as oil, gas, coal, timber, copper, potash, sand, gravel, uranium, molybdendum, vermiculite, sulfur, dolomite, limestone, iron, taconite, and salt. In fiscal 1981 severance taxes accounted for 4.3% of all state taxes collected.[20] The total severance taxes collected by all states in fiscal 1981 was $6.4 billion, 124% more than was collected in fiscal 1979.[21] Approximately 84% of severance tax collections in 1980 came from oil and gas production; an additional 8% of the receipts came from coal production.[22]

Alaska, Texas, Louisiana, Oklahoma, Montana, Wyoming, and New Mexico are the states with abundant oil, gas, and coal reserves,[23] and each of these states imposes a severance tax.[24] In all but one of these states, an increasing portion of the total tax generated in the state is from severance taxes. For example, in 1980 severance taxes represented 35.2% of total tax collections for Alaska, 27.2% for Wyoming, 21.9% for Louisiana, 21.7% for Montana, 24.6% for Oklahoma, 23.1% for New Mexico, and 22.6% for Texas.[25] This represented an increase over 1970 of 22.7% in Alaska, 22.1% in Wyoming, 18% in Montana, 14.5% in Oklahoma, 10.2% in New Mexico, and 8.8% in Texas.[26] Only in Louisiana did the proportion of severance taxes to total tax revenues decrease.[27]

B. *Property Tax*

Natural resources are directly or indirectly subject to a number of property taxes. First, a tax may be imposed on the land where the resource is extracted or on the improvements made to the land that enhance its value or increase the profits from the resources.[28] Second, a tax may be imposed on the mineral itself. In

20. P. Cuciti, H. Galper, R. Lucke, *supra* note 6, at 18. This was up from 3.1% in 1980. *Id.* at 17.

21. *Id.* at 15.

22. *Id.* at 14.

23. Of the 33 states imposing severance taxes in 1980, the following eight states—in order from highest to lowest—accounted for 87% of the total receipts from severance taxes: Texas, Louisiana, Alaska, Oklahoma, New Mexico, Kentucky, Florida, and Wyoming. *See* S. Kallek, *supra* note 19, at 2.

24. *See Severance, Production Taxes*, 2 ST. TAX GUIDE (CCH) ¶¶ 45-201 to -955 (Mar. 1982).

25. *See* S. Kallek, *supra* note 19, at Table 4.

26. *Id.*

27. In Louisiana this decrease was eight percent. *Id.*

28. Alaska, ALASKA STAT. § 43.56.020 (1977), Louisiana, LA. REV. STAT. ANN. § 47.643 (West 1970), and Oklahoma, OKLA. STAT. ANN. tit. 68 § 2419 (West 1966), do not tax reserves or land.

some states taxing authorities use the gross value of current production to determine the assessment of mineral properties.[29] In other states an attempt is made to assess mineral reserves at their market value without regard to whether the reserves are being developed.[30] Last, a personal property tax may be imposed on the machinery and equipment used to extract the minerals from the ground or to transport the minerals off the land.[31] Both state and local governments can impose these three types of ad valorem taxes. Because property taxes do not account for as much revenue as severance taxes, many states use severance taxes in lieu of all other ad valorem taxes that they could impose on energy resources.[32] In part, the preference for severance taxes is due to the administrative problems associated with property taxes. Complex valuation and assessment procedures are necessary to calculate and monitor the tax effectively. Assessors may be unable to assess accurately energy reserves because often the essential data is available only to the developer of the mineral. Economic studies show that, like severance taxes, consumers of the energy resource usually bear the burden of ad valorem property taxes.[33] Thus, energy-rich states through various forms of property taxing schemes potentially can export the burden of the tax to out-of-state consumers.

C. *Corporate Income Tax*

Many states impose a gross income or a net income tax on corporations engaged in business within the state, including businesses engaged in natural resources exploitation.[34] Unlike severance and property taxes, which are not imposed on activities

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29. Montana, MONT. CODE ANN. § 84-301 (1977), New Mexico, N.M. STAT. ANN. § 7-36-23 (1978), and Wyoming, WYO. STAT. § 39-2-202 (1977), utilize this method. Wyoming taxes the gross value of production until development is complete. Once mining has begun, the land is exempt from tax and production is taxed. Montana's assessment is determined on the basis of either gross or net proceeds. New Mexico's assessed value is one-third of taxable value, which is defined as 150% of annual gross product, less royalties.

30. Texas, TEX. TAX CODE ANN. § 23.17 (Vernon 1979), and California, CAL. REV. & TAX. CODE § 402.5 (West 1970), utilize this method.

31. Montana, MONT. CODE ANN. § 84-901-02 (1977), and New Mexico, N.M. STAT. ANN. §§ 7-34-1 to -34-8 (1980), utilize this method. Oklahoma, on the other hand, exempts from tax much of the personal property used in mining. OKLA. STAT. ANN. tit. 68 § 2420 (West 1966). *See Severance, Production Taxes*, 2 ST. TAX GUIDE (CCH) at ¶¶ 45-665, -590 (June 1982).

32. *See* T. Stinson, *supra* note 18, at 6.

33. *See* C. McClure, Tax Exporting, *supra* note 8, at 21.

34. In many states income is defined the same as income for federal tax purposes. *See* 2 ST. & LOC. TAX SERV. (P-H) (chart at ¶ 221) (Nov. 22, 1982).

outside the state, states often impose these taxes on out-of-state earnings. When a firm is engaged in a unitary business that extends into a number of states a state may employ formula apportionment to determine the portion of the firm's nationwide income upon which it can levy the state tax.[35] To derive the tax base, the state multiplies the nationwide income by an apportionment fraction—typically the corporation's payroll, property, and sales occurring within the state over the company's total United States payroll, property, and sales.[36] States may be able to obtain even greater revenues by choosing worldwide income instead of nationwide income as the starting point to which the apportionment fraction is applied,[37] or by varying the way in which payroll, property, and sales are determined.[38]

Consuming states using the unitary method of taxing income can capture a part of a corporation's revenues generated from activities outside the taxing state.[39] Thus, the taxing state can apply the apportionment formula to a base that includes all profits from the exploration, development, production, and marketing of the

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35. P. HARTMAN, *supra* note 12, § 9:18. The base amount may be worldwide income, national income, income from operations integrated with the state, or income from a separate functional or geographic area.

36. The apportionment formula is as follows:

$$\frac{\text{(sales + payroll + property) in state}}{\text{(sales + payroll + property) nationwide}} \times \text{nationwide income}$$

Assume the sum of in-state sales, payroll, and property for corporation *X* is $1,000,000. Assume the sum of nationwide sales, payroll, and property is $10,000,000. Corporation *X*'s national income for that year was $20,000,000. The apportionment tax would be calculated accordingly:

$$\frac{\$1{,}000{,}000}{10{,}000{,}000} \times \$20{,}000{,}000$$

tax base would be: $\frac{\$20 \text{ million}}{10 \text{ million}}$ or $2 million.

37. In the example above, if the state substituted the corporation's worldwide income for its nationwide income, the tax would increase—assuming, of course, that the corporation's total worldwide income was greater than its total national income.

38. A producing state potentially could transfer a significant measure of its tax burden to other states by assigning the sale to the point of origin rather than to the point of destination. Assigning the sale to the point of origin operates like a severance tax on the energy resource because the state taxes the sale, although the energy resource is transported to another state. Most states, however, assign sales to the point of destination. The point of destination method allows a state to tax the sales receipts from those energy resources that either remain in or are transported into the state and are sold there. Forty-two states assign sales to the state of destination. J. HELLERSTEIN & W. HELLERSTEIN, STATE AND LOCAL TAXATION 459 (1978).

39. *See* P. HARTMAN, *supra* note 12, § 2:4.

energy resource.[40] By increasing the base the state can increase the amount of tax revenue. Consuming states also may use point of destination rather than point of origin to determine the sales part of the apportionment formula. Such a modification of the apportionment rules will increase the tax revenues of the state.[41] In fact, economic studies have shown that consuming states that use point of destination generate more revenues from their corporate income taxes than those states that use point of origin.[42]

Energy-rich states that use formula apportionment may calculate the sales factor by point of origin rather than by point of destination.[43] For states that consume little of what they produce, such a modification of the apportionment rules will increase the tax revenues of the state. Economic studies have shown that energy producing states that use the point of origin approach generate more revenues from their corporate income taxes than those states that use the point of destination method.[44]

An increasing number of states use the worldwide income of a corporation as the base to which they apply the formula. Thus, a state determines a taxpayer corporation's apportionable tax base by combining its income with the income of its domestic and foreign affiliates.[45] This method of taxation increases the base to which the apportionment fraction is applied, and, thus, increases the amount of tax owed to the state.[46]

Several states do not use the traditional income apportionment scheme. Instead these states employ a separate accounting method in which they use one or more activities of a particular industry—pipeline, production, or refining—to measure taxable income.[47] Under this type of accounting a certain functional or geo-

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40. For example, Exxon operates only its Marketing department in Wisconsin. Under the unitary method of accounting Wisconsin can tax Exxon a portion of the income generated by its Exploration, Production, and Refining departments, which operate outside Wisconsin. *See* Exxon Corp. v. Wisconsin Dep't of Rev., 447 U.S. 207 (1980).

41. Under the point of destination accounting of sales the state taxes the receipts from sales of all goods transported into the state. Naturally, a consuming state will benefit from the destination approach; an energy-producing state, on the other hand, would increase its revenues by adopting the point of origin approach. *See supra* note 38.

42. *See* C. McClure, Tax Exporting, *supra* note 8, at 21.

43. *See supra* note 38.

44. *See* C. McClure, Tax Exporting, *supra* note 8, at 21.

45. *See supra* notes 36-37.

46. *Id.*

47. In this era of the multistate corporation the separate accounting method often is not practical. Under the separate accounting method the business operations of a multistate corporation within the taxing state are treated as though separate and distinct from the business operations outside the state. In many instances this approach is not practical be-

graphic area of an interstate business is treated separately from the rest of the business. A state computes taxable income as if the activities of the business were confined to that functional or geographic area. Therefore, this approach may require the firm or group of firms operating in the state to treat certain activities in the taxing state, or those functions that are profitable, as separate entities. The separate accounting method is the prevailing method for reporting income from oil production.[48]

Energy-producing states that employ the separate accounting method of taxation usually will tax upstream operations. Alaska, for example, utilizes separate accounting to measure the taxable income of oil and gas companies resulting from production and pipeline transportation.[49] The consuming states, on the other hand, are more likely to employ the separate accounting method to downstream operations, such as refining.[50] Although debates continue on who bears the burden of these types of taxes,[51] economic studies show that the incidence of the separate accounting method of tax is similar to that of a severance tax *if* certain deductions are disallowed or do not correspond to actual expenses incurred.[52] In such a case the incidence of the tax is actually on the consumer. If, on the other hand, the deductions correspond to actual expenses incurred, the incidence is similar to the regular income tax.[53]

Income taxes, like severance and property taxes, capture some share of the increasing tax revenues generated by energy operations. Although statistics are not available to determine exactly how much revenue states realize from the income taxes on energy exploitation, income statement data from the Federal Trade Commission from 1975 and 1980 show that after adjustments for inflation, net income before taxes increased 68% for the mining industry and 48.2% for manufacturers of petroleum and coal products.[54]

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cause a corporation is unable to determine accurately the amount of income derived from a particular operation. Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 VAND. L. REV. 21, 62 (1959).

An energy-producing state, however, has an incentive to utilize the separate accounting method for energy-related businesses because of the substantial amount of income derived from operations in the state.

48. *See* Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171, 191 (1970).

49. ALASKA STAT. §§ 43.19, 43.20.021 (Supp. 1980).

50. *See infra* notes 47-48 and accompanying text.

51. *See* C. McClure, Tax Exporting, *supra* note 8, at 20.

52. *Id.*

53. *Id.*

54. P. Cuciti, H. Galper, R. Lucke, *supra* note 6, at 21 (quoting statistics in U.S. FED-

Although imprecise, these statistics indicate that tax revenues generated from the income taxes of energy-related firms are becoming increasingly important.

D. *Other State Taxes and Taxing Schemes*

In addition to severance, property, and income taxes, states impose numerous excise taxes. Excise taxes are based on the exercise of a privilege, the doing of an act, or the engaging in an occupation.[55] Severance taxes are perhaps the most common type of excise tax affecting energy resources. Other excise taxes, however, are also important. For example, a common form of excise tax is a tax imposed on the privilege of doing business in the state.[56] Regardless of its name—gross receipts tax, franchise tax, occupation tax, or license tax—these taxes usually are measured by the gross receipts derived from the activities within the state.[57] States impose privilege taxes on oil and gas companies in addition to other types of business. For example, West Virginia utilizes gross receipt taxes instead of severance taxes.[58] Many states have special excise taxes that relate to particular aspects of natural resource exploitation. New Mexico, for example, had an electrical generation tax.[59] Most states have a combination of several excise taxes that affect natural resources. Not infrequently, a state may have in addition to a severance tax several other excise taxes, such as a tax on mineral production and a corporate license tax.[60]

Sales and use taxes also are forms of excise taxes. Sales taxes are imposed on the sale of goods and services within the state.[61] Use taxes complement sales taxes. They are imposed on the use, storage, withdrawal, or consumption of a tangible good, and usually are applied only to a good purchased outside the state.[62] Al-

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ERAL TRADE COMMISSION, QUARTERLY FINANCIAL REPORT FOR MANUFACTURING, MINING AND TRADE CORPORATIONS, (Wash., D.C., U.S. Government Printing Office)).

55. Litigation often results over whether a particular tax is a property tax or an excise tax because many state constitutions contain limitations on either property taxes or excise taxes. *See* United States v. Nevada Tax Comm'n, 291 F. Supp. 530, 534 (D. Nev. 1968).

56. *See* P. HARTMAN, *supra* note 12, § 2:17.

57. *Id.* § 8.1, at 420; *see* C. McClure, Tax Exporting, *supra* note 8, at 22.

58. W. VA. CODE § 11-15-7 (1974). *See* Statement of S. Kallek, *supra* note 19, at 3.

59. The legislature repealed N.M. STAT. ANN. § 7-9-80 (1978) effective July 1, 1982. 1982 N.M. Laws, ch. 18, § 27. *See infra* text accompanying notes 229-33.

60. For example, Montana has a severance tax, a tax on mineral production, a corporation license tax, a mining property tax, a mining property tax, a mining equipment tax, and a coal retailer's tax. *See supra* notes 10-54 and accompanying text.

61. P. HARTMAN, *supra* note 12, § 10:1, at 577.

62. *Id.* § 10:1, at 578.

though these types of taxes generally do not directly affect energy resources, they may have a substantial indirect effect in some cases. For example, Louisiana imposed a "first use" tax on any natural gas brought into Louisiana that previously was not subjected to taxation by another state or the United States.[63] This tax, which raised substantial revenues[64] and burdened out-of-state consumers,[65] subsequently was struck down by the Supreme Court.[66]

In addition to the great variety of taxes affecting natural resources, great differences exist within each taxing scheme and between various taxing schemes. States may provide for credits, exemptions, and deductions that can modify the incidence and effect of the tax. For example, some taxing schemes provide for exemptions or credits for residents, which can result in a transfer of the tax burden from residents to nonresidents.[67] Similarly, different taxing schemes within a state may be interrelated to cause a discriminatory effect.[68] Consequently, a careful examination of state taxes on energy resources requires a discussion of not only all of the various kinds of taxes, but also the interrelationship of the taxing schemes within the taxing state.

III. CONSTITUTIONAL RESTRICTIONS ON ENERGY TAXATION

The Constitution contains five provisions under which a taxpayer may challenge an allegedly discriminatory state tax: the commerce clause, the due process clause, the equal protection clause, the privileges and immunities clause, and the supremacy clause. The Supreme Court in *Complete Auto Transit v. Brady*[69] set forth the issues presented under the commerce clause: (1) Does a sufficient minimum connection or nexus exist between the taxed activity and the tax? (2) Is the tax properly apportioned? (3) Does the tax discriminate against or burden interstate commerce? and

63. LA. REV. STAT. ANN. §§ 47:1301-47:1307 (West Supp. 1981).

64. Estimated annual revenues ranged from $150 million to $275 million. *See* Maryland v. Louisiana, 451 U.S. 725, 731 & n.7 (1981); Comment, *The Louisiana First-Use Tax: Does It Violate the Commerce Clause?*, 53 TUL. L. REV. 1474, 1474 (1979).

65. Ninety-eight percent of the gas that entered Louisiana from operations on the outer continental shelf eventually was sold to out-of-state consumers. Maryland v. Louisiana, 451 U.S. 725, 729 (1981).

66. *Id.; see infra* notes 155-76 and accompanying text.

67. The Louisiana first use tax statute and other Louisiana statutes provided for a number of exemptions from and credits for the first use tax where the tax, for tbe most part, did not burden Louisiana consumers. Maryland v. Louisiana, 451 U.S. 725, 732-33 (1981).

68. *See infra* notes 155-76 and accompanying text.

69. 430 U.S. 274 (1977).

(4) Is the tax fairly related to the services provided by the state?[70] Similarly, the due process clause requires that the taxed activity bear a rational relationship to the taxing state and that the state fairly apportion the tax.[71] Further, the due process clause requires that a state not take the taxpayer's property unfairly and without proper compensation. Under the equal protection clause the issues presented are: (1) Does the tax have a legitimate purpose?[72] and (2) Could the lawmakers conceivably believe that the use of the challenged classification would promote that purpose?[73] The privileges and immunities clause, which affords protection only to individuals, not corporations,[74] prohibits discriminatory tax treatment of nonresidents unless the discriminatory tax bears a reasonable relationship to a problem presented by nonresidents.[75] Last, under the supremacy clause the issues presented are: (1) Did Congress expressly preempt state action?[76] (2) Does congressional action clearly and unmistakably show that Congress intended to supersede state action?[77] and (3) Does the state statute conflict with a federal enactment and stand as a direct obstacle to its execution or purpose?[78] This Article discusses each of these constitutional limitations.

A. *Commerce Clause*

Article I, section 8 of the United States Constitution states that Congress has the power "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[79] Although this language appears to address only the affirmative powers of Congress, it also speaks to the negative restric-

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70. *Id.* at 277-78.

71. *See* National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 (1967); Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 174 (1949); P. HARTMAN, *supra* note 12, § 2:3, at 19-20.

72. P. HARTMAN, *supra* note 12, § 3:2, at 139.

73. Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 364-65 (1973); P. HARTMAN, *supra* note 12, § 3:1, at 135-36.

74. Blake v. McClung, 172 U.S. 239, 259 (1898); Paul v. Virginia, 75 U.S. (8 Wall.) 168, 178 (1869).

75. Toomer v. Witsell, 334 U.S. 385, 396 (1948); Travis v. Yale & Towne Mfg. Co., 252 U.S. 60, 79 (1920); P. HARTMAN, *supra* note 12, §§ 4:2-4:3.

76. *See* Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947); Hines v. Davidowitz, 312 U.S. 52 (1941); *see generally* J. NOWAK, R. ROTUNDA, & J. YOUNG, CONSTITUTIONAL LAW 267-79 (1978).

77. *See supra* note 76.

78. *Id.*

79. U.S. CONST. art. I, § 8.

tions on the states' power to invade federal jurisdiction. The cases under the commerce clause fall into three categories: (1) Those cases dealing with Congress' affirmative power to pass legislation; (2) those cases dealing with the state's power to pass certain regulatory measures; and (3) those cases dealing with the state's power to pass certain taxation measures. The latter two categories relate to the negative or dormant implications of the commerce clause.[80]

Until *Complete Auto Transit v. Brady*[81] and *Commonwealth Edison Co. v. Montana*[82] courts analyzed the validity under the commerce clause of state taxes on natural resources by a mechanical test set forth in the "*Heisler* trilogy" cases of the 1920's.[83] The Court in a long series of decisions had held that because of the commerce clause, states lacked the power to tax interstate and foreign commerce since the power of Congress over such commerce was exclusive.[84] This rationale, therefore, compelled courts to determine what was interstate and foreign commerce for tax purposes. In making this determination courts looked to whether the taxed activity was local in nature or in interstate commerce. If local, the taxing authority could tax the activity, and the commerce clause was inoperative—even if the activity affected interstate commerce. If nonlocal or interstate, the activity was immune from direct state taxation. Thus, mining,[85] manufacturing,[86] and agricul-

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80. On its face the commerce clause is simply a conferral of power on Congress to regulate commerce among the states. The commerce clause, however, is not only a grant of authority to Congress, but also a significant, independent limitation on state power. Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1851); *see* Anson & Schenkkan, *Federalism, the Dormant Commerce Clause, and State-Owned Resources*, 59 TEX. L. REV. 71 (1980); Blumstein, *Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax Treatment of Out-of-State Tax-Exempt Bonds*, 31 VAND. L. REV. 473 (1978); Browde & DuMars, *State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier*, 60 ORE. L. REV. 7 (1981); Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425 (1982); Maltz, *How Much Regulation Is Too Much—An Examination of Commerce Clause Jurisprudence*, 50 GEO. WASH. L. REV. 47 (1981); Schwartz, *Commerce, the States, and the Burger Court*, 74 NW. U.L. REV. 409 (1979); Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125; Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487 (1981).

81. 430 U.S. 274 (1977).

82. 453 U.S. 699 (1981).

83. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922).

84. *See, e.g.*, Minnesota v. Blasius, 290 U.S. 1 (1933); Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925); Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1887); *see* P. HARTMAN, *supra* note 12, § 2:18, at 101.

85. Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923).

86. American Mfg. Co. v. City of St. Louis, 250 U.S. 459 (1919).

tural production,[87] were local and prefatory to interestate commerce and, therefore, within the exclusive control of the state. The selling and shipping of goods already mined and produced to customers in another state, however, was interstate commerce.

In *Heisler v. Thomas Colliery Co.*[88] a stockholder in Thomas Colliery Company brought suit to challenge the constitutionality of a Pennsylvania severance tax on anthracite coal and to enjoin defendant company and its directors from complying with the tax.[89] Plaintiff claimed that the tax was a collection of tribute from other states, imposed because Pennsylvania had a monopoly on anthracite coal and exported most of that coal to other states.[90] Further, taxpayer argued that the tax discriminated against interstate commerce, which the commerce clause prohibited.[91] The Supreme Court concluded that the tax was on the local activity of severing natural resources from the earth and did not concern interstate commerce. The Court stated:

> The reach and consequences of the contention repel its acceptance. If the possibility, or, indeed, certainty of exportation of a product or article from a State determines it to be in interstate commerce before the commencement of its movement from the State, it would seem to follow that it is in such commerce from the instant of its growth or production, and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet "on the hoof," wool yet unshorn and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production.[92]

The Court followed this mechanical rule in *Oliver Iron Mining Co. v. Lord*,[93] a case in wbich taxpayers challenged a Minnesota occupation tax upon "'[e]very person engaged in the business of mining or producing iron ore or other ores' within the State."[94] As

87. Heisler v. Thomas Colliery Co., 260 U.S. 245, 259-60 (1922).

88. 260 U.S. 245 (1922).

89. The tax statute provided for a 1½% tax on the value of each ton of anthracite coal "mined, 'washed, or screened, or otherwise prepared for market' . . . ." *Id.* at 253.

90. *Id.* at 258. Nine northeastern states joined plaintiff in the suit.

91. *Id.* at 252-53.

92. *Id.* at 259-60; *see also* Canton R.R. Co. v. Rogan, 340 U.S. 511, 515 (1951) (similar conclusion concerning tax that implicated both the commerce clause and the import-export clause).

93. 262 U.S. 172 (1923).

94. *Id.* at 174-75. The tax was determined from the "value of the ore at the place it is

in *Heisler*, taxpayers asserted that mining, if not actually a part of interstate commerce, was connected so closely with it that to tax mining was to burden interstate commerce.[95] Further, most of the iron ore was destined for out-of-state customers.[96] The Court, however, rejected the taxpayers' claim:

> Plainly the facts do not support the contention. Mining is not interstate commerce, but, like manufacturing is a local business subject to local regulation and taxation. . . . Its character in this regard is intrinsic, is not affected by the intended use or disposal of the product, is not controlled by contractual engagements, and persists even though the business be conducted in close connection with interstate commerce.[97]

In the last case of the trilogy, *Hope Natural Gas Co. v. Hall*,[98] taxpayer challenged a West Virginia annual privilege tax imposed on "every person engaging . . . in the business of mining and producing for sale, profit, or use, any coal, oil, natural gas, limestone, sand or other mineral product. . . ."[99] The Court held that the tax did not violate the commerce clause because production was a purely local activity, and the tax was imposed on oil and gas at the wellhead before it entered the stream of interstate commerce.[100]

The Court followed the "mechanical test" established in the *Heisler* trilogy as recently as 1961 and 1969. In *Alaska v. Arctic Maid*[101] California and Washington taxpayers challenged an Alaska license tax of four percent of the value of salmon caught in Alaskan territorial waters. The salmon were caught in Alaska by "catcher boats," which taxpayers owned or had under contract, and then transferred to taxpayers' freezer ships outside of Alaskan territorial waters. Taxpayers froze the salmon aboard the freezer ships and eventually returned to Washington, where the salmon were canned. The Supreme Court held that the license tax on freezer ships, as applied to salmon taken in Alaska's territorial waters, was not invalid as a burden on interstate commerce:

> The process of gathering fish either through the catcher boats that are part of respondents' fleet or through independent operators is a "local activity" in a vivid sense of the term. We see no reason why our cases involving the taking of shrimp and the extraction of ore are not dispositive of this controversy. The *Oliver Iron* case is indeed a first cousin of the present case. Here, as

'brought to the surface of the earth . . . .' " *Id.* at 175.

95. *Id.* at 177.
96. Less than two percent of the ore was sold and used in Minnesota. *Id.* at n.2.
97. *Id.* at 178-79 (citations omitted).
98. 274 U.S. 284 (1927).
99. *Id.* at 285-86 n.3.
100. *Id.* at 288.
101. 366 U.S. 199 (1961).

there, the tax is an occupation tax. Here, as there, the market for the product obtained locally is interstate, the taking being a step in a process leading to an interstate market.[102]

Similarly, the Supreme Court in *Dunbar-Stanley Studies v. Alabama*[103] distinguished between local activity and interstate activity. In *Dunbar-Stanley* Alabama taxed photograph galleries and persons engaged in photography for each county, town, or city in which they worked. For a photographer or gallery at a fixed location, the maximum tax was twenty-five dollars per year. For a transient photographer, the tax was five dollars per week for each location in which he worked. Taxpayer, an out-of-state photography firm, which maintained no office, place of business, or inventory in Alabama, contracted with J.C. Penney stores in Alabama periodically to send photographers to the stores for a short time. Photographers utilized factilities and advertising furnished by the department stores, took pictures, and sent the exposed film to an office in North Carolina that developed, finished, and returned the film to the department stores in Alabama. Taxpayer challenged the transient photographer tax assessed against it. The Supreme Court held that the tax was constitutionally permissible:

It could hardly be suggested that if J.C. Penney had set up its own resident or transient photography studies, using its own employees, such a photography business would have been exempt from State licensing merely because it chose to send the exposed film out of of the State for processing. The extraction of a natural resource within a state is not immunized from state taxation merely because, once extracted, the product will immediately be shipped out of the State for processing and sale to consumers.[104]

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102. *Id.* at 203-04 (citation omitted); *see also* Utah Power & Light Co. v. Pfost, 286 U.S. 165 (1932) (generation of electricity from waterpower within the state is a local activity; transmission of electricity over wires from the generator to consumers in another state is an interstate activity).

103. 393 U.S. 537 (1969).

104. *Id.* at 541. The Court's somewhat tortured inquiry into whether the taxed activity was local or interstate was the result of the "tax-free haven" approach to interstate commerce. *See* Hellerstein, *Foreword State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335, 337 (1976). Thus, the Court in Spector Motor Service v. O'Connor, 340 U.S. 602 (1951), held that states could not tax the privilege of transacting interstate business. This blanket prohibition against "direct" taxation on interstate commerce gradually ceded to the notion that interstate commerce legitimately could be expected to share the costs of running government. "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938). In Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), the Court held that a state may tax directly the net income from interstato business. "[I]t is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State." *Id.* at 461-62. Thus, the Court

The local versus interstate distinction raised in these tax cases appears to conflict with the practical effects test used in post-New Deal cases addressing Congress' affirmative powers under the commerce clause.[105] The Court's inquiry in challenges to federal power under the commerce clause is whether the activity sought to be regulated affects interstate commerce.[106] If the activity substantially affects interstate commerce, then Congress has the power to regulate. Thus, for example, the Supreme Court in *Wickard v. Filburn*[107] held that Congress could regulate the agricultural activity of a farmer growing wheat for personal consumption only. In *Fry v. United States*[108] the Court concluded that the activities of state employees were subject to federal control. Similarly, in *Hodel v. Virginia Surface Mining & Reclamation Association*[109] the Court held that the regulation of surface coal mining is necessary to protect interstate commerce. These cases indicate that Congress' authority to regulate commerce is extensive and applies to local ac-

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became less concerned with whether the incidence of a tax fell on interstate commerce directly or indirectly. *See* Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975); Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975); Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term:* Standard Pressed Steel *and* Colonial Pipeline, 62 VA. L. REV. 149 (1976). Finally, the Court in 1977 expressly overruled *Spector* in Complete Auto Transit v. Brady, 430 U.S. 274 (1977).

In *Complete Auto Transit* Mississippi levied a privilege tax on doing business within the state. Taxpayer was a Michigan corporation that transported motor vehicles by motor carrier for General Motors, which manufactured the vehicles outside of Mississippi and shipped them by rail into the state. Taxpayer loaded vehicles onto its trucks for transportation elsewhere in the state. At the outset, the Court assumed that this transportation was in interstate commerce. *Id.* at 276 n.4. The Court rejected the formalistic *Spector* rule and stated that the basic inquiry is whether the results from a particular tax are "forbidden by the Commerce Clause." *Id.* at 285. The Court concluded that a tax does not violate the commerce clause if "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.* at 279.

105. Affirmative commerce clause decisions have evolved in two lines. *Compare* Houston, E. & W. Tex. Ry. Co. v. United States, 234 U.S. 342 (1914) (congressional authority extends to all matters having a close and substantial relation to interstate commerce) *with* United States v. E.C. Knight Co., 156 U.S. 1 (1895) (Congress has power under commerce clause to reach local economic activities only if activity has a "direct" rather than "indirect" effect on interstate commerce). Under the *Knight* approach the Court distinguished between manufacturing and commerce. The former had only an indirect effect on interstate commerce and, thus, was beyond the reach of Congress. *See* Blumstein, *supra* note 80, at 486 n.53.

106. *See, e.g.,* Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937).

107. 317 U.S. 111 (1942).

108. 421 U.S. 542 (1975).

109. 452 U.S. 264 (1981); *see also* Hodel v. Indiana, 452 U.S. 314 (1981) (surface coal mining on prime farmland affects interstate commerce in agricultural products).

tivity as long as that activity affects interstate commerce. Until *Commonwealth Edison Co. v. Montana*[110] uncertainty existed about whether this practical effects standard would apply to the negative restrictions on the state's power to tax.[111]

Montana in 1975 raised its maximum severance tax on coal extraction to thirty percent of sales price.[112] Four Montana coal companies and eleven out-of-state consumers of Montana coal challenged the severance tax under the commerce and supremacy clauses and sought refunds of over $5.4 million in taxes paid under protest and an injunction against further collection of the tax.

The trial court upheld the tax and dismissed the complaints.[113] On appeal, the Montana Supreme Court affirmed,[114] concluding "that the severance of coal here is a taxable event that precedes entry into interstate commerce" and is "not an interstate activity" and that, in such circumstances, the commerce clause imposes no limit on the power of the states to tax.[115] Alternatively, the Montana court held that even if the commerce clause did apply, the tax nevertheless met the four-pronged *Complete Auto Transit* test.[116]

In the United States Supreme Court taxpayers argued, as a threshold matter, that the Supreme Court should abandon the mechanical test of *Heisler*, which excluded mining from the scope of commerce clause protection.[117] The Court noted that *Heisler*

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110. 453 U.S. 609 (1981).

111. *But cf.* Hughes v. Oklahoma, 441 U.S. 322, 326 n.2 (1979) ("The definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation.").

112. MONT. CODE ANN. §§ 15-35-1-1 to -111 (1981). The tax is levied at rates depending on the value, energy content, and method of extraction of the coal. The maximum tax is 30% of the contract sales price, which is defined as "the price of coal extracted and prepared for shipment f.o.b. mine, ..." MONT. CODE ANN. § 15-35-102 (1981).

113. *See* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 613 (1981).

114. Commonwealth Edison Co. v. State, 615 P.2d 847 (1980), *aff'd*, 453 U.S. 609 (1981).

115. *Id.* at 854.

116. *See supra* notes 69-70 and accompanying text & note 104. Plaintiffs did not dispute tbat the Montana tax met the first two parts of the *Complete Auto Transit* test. Clearly, a substantial nexus existed between the taxed activity and the state. Moreover, the severance of coal occurred exclusively in Montana. Commonwealth Edison Co. v. State, 615 P.2d at 855. The tax met the third part of the test—whether the tax discriminated against interstate commerce—because the tax rate remained the same for coal sold both in-state and out-of-state. *Id.* at 856. The Montana court also found that the tax passed the fourth prong of the test—whetber the tax was fairly related to services provided by the state—because the coal producers enjoyed the "advantages of a civilized society" in Montana. *Id.*

117. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 614 (1981).

was decided in an era when items in interstate commerce were immune from direct state taxation.[118] Thus, to preserve state taxing authority, the Court had defined interstate commerce narrowly. Since that time, however, the mechanical test of *Heisler* had given way to a commerce clause analysis of state taxation that emphasized "the practical effect of a challenged tax."[119] Thus, the Court concluded that it no longer should treat mining as outside the protection of the commerce clause.[120]

The Court adopted the Montana Supreme Court's alternative holding and held that the Montana tax survived commerce clause scrutiny under the *Complete Auto Transit* test. The facially neutral tax did not discriminate against interstate commerce within the meaning of the third prong of the test even if the tax effectively shifted state tax burdens to out-of-state coal consumers.[121] Finally, the Court found that, because the tax was not flat but was proportional to in-state business activity, it bore a "fair relation" to services provided by the state.[122]

This Article next explores in detail the four parts of the *Complete Auto Transit* test. The importance of this test cannot be underestimated because after *Commonwealth Edison* it controls the validity under the commerce clause of all state taxes on natural resources.

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118. *Id.; see supra* text accompanying note 105.

119. Commonwealth Edison Co. v. Montana, 453 U.S. at 615 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443 (1980)).

120. Commonwealth Edison Co. v. Montana, 453 U.S. at 615-16. Although the Court abandoned the *Heisler* approach, it likely would have reached the same result in *Heisler* and its progeny under the *Complete Auto Transit* test.

121. *Id.* at 618. Taxpayers argued that the Montana tax discriminated against interstate commerce because 90% of Montana coal is shipped to out-of-state consumers. *Id.* at 617-18.

122. *Id.* at 628-29. The Court dismissed botb of taxpayers' supremacy clause arguments. First, taxpayers had argued that the Montana tax would alter the statutory formula for the allocation between the state and federal government of "economic rents" from the leasing of federal land for mining as provided by the Mineral Lands Leasing Act of 1920, ch. 85, 41 Stat. 437 (1920), *amended by* Federal Coal Leasing Amendments Act of 1975, Pub. L. 94-377, 90 Stat. 1083 (1976) (codified at 30 U.S.C. §§ 181-287 (1976 & Supp. IV 1980)). The Court, however, noted that § 32 of the Mineral Lands Leasing Act, 30 U.S.C. § 189 (1976 & Supp. IV 1980), explicitly authorized state severance taxes on federal lessees and did not specify any limit on the taxes. *Id.* at 631.

Second, taxpayers argued that the Montana tax frustrated congressional policy, reflected in a myriad of statutes, favoring coal use, *e.g.*, Powerplant and Industrial Fuel Use Act of 1978 § 201, 42 U.S.C. § 8311(1) (Supp. IV 1980) (prohibits use of natural gas or petroleum fuel by new electric powerplants). The Court concluded that only a specific federal intent to preempt an area, as opposed to a general "national policy," is sufficient to bar contrary state actions. *Id.* at 634.

1. Nexus

A court will not sustain a state tax under the commerce clause unless a substantial nexus exists between the state and the person, property, or activity being taxed.[123] The nexus criterion requires that a sufficient contact, connection, tie, or link exist with the taxing state to support the tax. If the state has given anything for which it can ask a return, then the tax has a sufficient nexus. For example, the state legitimately can ask for taxes to support local services because it provides citizens the benefits of police and fire protection and the use of roads and highways. Similarly, no nexus problem arises in the case of a severance tax. As the Supreme Court held in *Commonwealth Edison,* "there can be no argument here that a substantial, in fact, the only nexus of the severance of coal is established in [the state where it is extracted]."[124] Further, a nexus problem usually does not arise for other excise taxes or for property or income taxes. Courts have even held that the presence of a single resident is sufficient to establish a nexus for purposes of gross receipt taxes.[125] For property taxes, a sufficient nexus exists if the property used, stored, or otherwise comes to rest in the state.[126] If, however, the property merely is passing through the state—as in the case of trucks, airplanes, or railroad cars—the connection between the property and the benefits of state services may not be sufficient to justify taxation.[127] The nexus issue may arise in the area of income taxation of multistate business. If an out-of-state business activity is a separate business with no contacts with the taxing state, then no nexus exists for that state to include that income from that activity in the tax base. If, on the other hand, the out-of-state business activity is part of a unitary enterprise doing business within the state, then a sufficient nexus exists.[128]

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123. *See, e.g.,* National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551 (1977).

124. 453 U.S. at 617 (quoting Commonwealth Edison Co. v. State, 615 P.2d at 855).

125. *See, e.g.,* Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975); *see also* Scripto, Inc. v. Carson, 362 U.S. 207 (1960) (Florida use tax upheld on Georgia corporation having no office, property, or regular full-time employees in Florida); *infra* note 190 and accompanying text.

126. *See* United Air Lines v. Mahin, 410 U.S. 623 (1973).

127. *See, e.g.,* Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925); United Fuel Gas Co. v. Hallanan, 257 U.S. 277 (1921); Eureka Pipe Line Co. v. Hallanan, 257 U.S. 265 (1921). *But see* Interstate Oil Pipe Line Co. v. Stone, 337 U.S. 662 (1949) (upholding tax on privilege of shipping oil through the State).

128. *See infra* notes 143-48 and accompanying text.

2. Apportionment

The concept of apportionment prevents the multiple taxation of a taxpayer whose activities affect interstate commerce. Apportionment requires that some reasonable basis exist for calculating the percentage of income or the percentage of the value of the property that each state may tax.[129] Apportionment, however, does not require that the total tax burden on the taxpayer may not be in excess of that which the taxpayer would bear if the taxpayer were taxed only by one state. It requires only that the state not extract from the taxpayer more than a fair share of the tax burden. As with the problem of nexus, the problem of apportionment usually arises when the taxed person, property, or activity is in the stream of interstate commerce. To the extent that the taxing state directs the taxes in question at activities within that state, these taxes are apportioned automatically; and the taxpayer has the difficult burden of showing multiple taxation.[130] For example, property taxes are generally not apportioned.[131] Similarly, no issue of fair apportionment arises for severance taxes because " 'the severance can occur in no other state' and 'no other state can tax the severance.' "[132] Other excise taxes can create apportionment problems if the tax is unrelated to actual activities of the taxpayer within the state. In *Michigan-Wisconsin Pipe Line Co. v. Calvert*[133] the Court concluded that a Texas occupation tax on "gathering gas" was unconstitutional because the state imposed the tax on the entire volume of gas.[134] Similarly, the Court in *General Mo-*

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129. *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-19 (1978).

130. A court is more likely to uphold taxes on net receipts than taxes on gross receipts because they take into account the profitability of a business. *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959); Memphis Natural Gas Co. v. Beeler, 315 U.S. 649 (1942); Hartman, *The Commerce Clause and the States' Power to Tax the Oil and Gas Industry*, INST. ON OIL & GAS L. & TAX'N 387, 390-392 (1956).

131. This is logical because the real property to be taxed can exist only in one state, which, thus, has the authority to levy taxes upon it.

132. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 617 (1981) (quoting Commonwealth Edison Co. v. State, 615 P.2d at 855). In addition, the Court requires that the taxpayer show *actual* multiple tax burdens, not simply the *risk* of multiple tax burdens. *See, e.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978); Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978); *see* P. HARTMAN, *supra* note 12, § 2:16, at 82-83.

133. 347 U.S. 157 (1954).

134. Although the Court did not decide *Calvert* on this basis— since at the time of the case, a state could not "directly" tax interstate commerce—later cases have interpreted it as holding that the challenged tax was not properly apportioned. *See* Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 749 n.18 (1978).

tors Corp. v. District of Columbia[135] held that a city franchise tax on General Motors was unconstitutional because the tax was measured exclusively by sales when all of the cars sold in the city were manufactured elsewhere. In *General Motors Corp. v. Washington,*[136] however, the Court held that a tax on the privilege of doing business within the state, measured by gross receipts from all sales, including out-of-state sales, was constitutional, even though the taxpayer's in-state activities were not entirely responsible for those sales.[137] Similarly, the Court refused to invalidate a privilege tax on an interstate railroad system that was based on the railroad's intrastate travel mileage.[138] In general, as long as the state levys the gross receipts, license, franchise, or other excise tax on the value of the services performed within the state, the tax is apportioned properly and multiple burdens do not occur.[139]

The apportionment issue arises most frequently in the income tax area. Clearly, a business engaged in interstate commerce should not be required to pay income taxes in more than one state on its total income. In *Nippert v. City of Richmond*[140] the Court held that an unapportioned tax on the total gross earnings of an interstate business was unconstitutional because it was unrelated to the amount of solicited business actually done within the state. The Court stated that imposition of similar taxes by other states could burden the interstate business and eventually destroy it.[141] The Supreme Court generally has taken the view that a state may tax income from activity generated in another state or abroad if the intrastate and extrastate activities form part of a single unitary business.[142] Thus, in *Mobil Oil Corp. v. Commissioner of Taxes*[143] the Court upheld a Vermont corporate income tax that reached dividends from Mobil's subsidiaries and affiliates abroad because Mobil failed to show "that the income was earned in the course of activities unrelated to the sale of petroleum products in that

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135. 380 U.S. 553 (1965).
136. 377 U.S. 436 (1964).
137. *Id.* at 441.
138. Nashville, C. & St. L. Ry. v. Browning, 310 U.S. 362 (1940).
139. Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978).
140. 327 U.S. 416 (1946).
141. *Id.* at 423-24.
142. *See* Butler Bros. v. McColgan, 315 U.S. 501, 506-08 (1942); Ford Motor Co. v. Beauchamp, 308 U.S. 331, 336 (1939); *cf.* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272 (1978).
143. 445 U.S. 425 (1980).

State."[144] The Court noted that Mobil's foreign activities were part of its integrated petroleum business that operated in Vermont and not a discrete and separate operation.[145] Similarly, in *Exxon Corp. v. Department of Revenue*[146] the Court treated Exxon's seven functional operating departments as a single unitary business, even though only the Marketing department was located within Wisconsin.[147] The Court reasoned that the marketing activity in Wisconsin was related sufficiently to the other three Exxon departments to make Wisconsin's tax legitimate.[148]

Recently, however, in *ASARCO, Inc. v. Idaho State Tax Commission*[149] the Court limited the application of the single unitary business concept. In *ASARCO* the Court struck down a corporate income tax that Idaho had levied on intangible income received by an out-of-state corporation, which was mining silver in Idaho, from four subsidiary corporations that had no connection with Idaho.[150] Writing for the majority, Justice Powell found that the tax violated the due process clause because the parent corporation and its subsidiaries were not a single unitary business and, hence, the Idaho levy improperly reached across its borders.[151] The Court reached a similar result in *F. W. Woolworth Co. v. Taxation and Revenue Department*.[152] Because the foreign subsidiaries of the Woolworth retail store chain were not functionally integrated with the domestic parent corporation and did not share a centralized management with the parent, New Mexico's taxation of foreign subsidiaries' dividends violated the due process clause.[153] As in *ASARCO*, the Court found New Mexico's relationship with the subsidiaries to be too tenuous to justify the tax.[154] Thus, *Woolworth* and *ASARCO* clearly limit the authority of a state to

144. *Id.* at 439.

145. *Id.* The Court cautioned that the *Mobil* holding did not imply that all dividend income received by interstate corporations was taxable in every state in which it did business. Such a tax on dividends might violate due process if the business activities of the dividend payor were unrelated to the activities of the recipient in the taxing state. *Id.* at 441-42.

146. 447 U.S. 207 (1980).

147. *Id.* Exxon was "a highly integrated business which benefits from an umbrella of centralized management and controlled interaction." *Id.* at 224.

148. *Id.* at 225.

149. 102 S. Ct. 3103 (1982).

150. *Id.* at 3115.

151. *Id.*

152. 102 S. Ct. 3128 (1982).

153. *Id.* at 3138-39.

154. *Id.*

tax income arguably derived from beyond its borders. Indeed, as the link between income source and the taxing state becomes attenuated, the Court appears ready to use the due process clause to strike down the tax.

3. Discrimination

While apportionment deals with the multiple taxation of taxpayers engaged in interstate activities, discrimination deals with the unfavorable treatment of interstate commerce vis-a-vis intrastate commerce. To determine discrimination, one must evaluate the burdens on interstate commerce by balancing state and federal interests.[155] In contrast to the nexus and apportionment criteria, the discrimination criterion is more likely to provide the basis for invalidating a state taxing scheme.[156] On numerous occasions the Court has struck down state taxes that placed a greater burden on out-of-state goods or activities than on competing state goods or activities, or that provided a direct commercial advantage to local business.[157] For example, in *Boston Stock Exchange v. State Tax Commission*[158] the Supreme Court held that a New York transfer tax on the sale of securities that operated to give investors a financial incentive to sell securities in New York was unconstitutional.[159] The Court will not sustain any form of discrimination against interstate commerce, whether in the form of a burden imposed only on foreign commerce or in the form of a disguised competitive advantage for in-state business.[160] Thus, in *Lewis v. BT Investment Managers*[161] the Court struck down a Florida statute that prohibited out-of-state, but not in-state, bank holding companies from owning or controlling a business that furnished invest-

155. *See* Pike v. Bruce Church, Inc., 397 U.S. 137 (1970); Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950); California v. Zook, 336 U.S. 725 (1949).

156. *See* Bison, *Economic Protective Powers of States Under the Commerce Clause,* 38 GEO. L.J. 590, 593 (1950); *Developments in the Law—Federal Limitations on State Taxation of Interstate Business,* 75 HARV. L. REV. 953, 962 n.44 (1962).

157. *See, e.g.,* Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963); Hale v. Bimco Trading, Inc., 306 U.S. 375 (1939).

158. 429 U.S. 318 (1977).

159. New York argued that since the maximum tax distinguished between two types of nonresidents, those who made in-state sales and those who made out-of-state sales, and did not discriminate against nonresidents in favor of residents, the tax, therefore, was valid. The Court rejected this argument: "A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce." *Id.* at 334-35.

160. *Id.*

161. 444 U.S. 822 (1980).

ment advisory services to the general public. The lower court observed, "[W]here simple economic protectionism is effected by state legislation, *a virtually per se rule of invalidity* has been erected."[162] Only in a few instances have the courts sanctioned different treatment of interstate and local business.[163]

The cases concerning state regulations best illustrate this balancing approach. For example, states have regulated the weight of trucks,[164] the length of trucks,[165] the length of trains,[166] and the equipment and safety gear on trucks[167] and trains.[168] Although these state regulations have a strong presumption of validity, the state's justification for safe travel is sometimes not as great as the federal interest in the free flow of commerce. Similarly, states have attempted to regulate activities concerning public health, for which exists an even stronger presumption of validity.[169] Notwithstanding this bias, when the economic welfare of the out-of-state resident might be jeopardized, the courts are likely to strike down the state statute.

Precedents exist for balancing state and federal interests, although the balancing in taxation cases is somewhat different from the balancing in regulation cases.[170] In regulation cases the interest of the state is to protect the health, welfare, and safety of its citizens and the economic well-being of the state; in taxation cases the interest of the state is to provide revenue to finance the workings of the government.

The Court in *Commonwealth Edison,* however, did not attempt to balance the state and federal interests. Plaintiffs in *Commonwealth Edison* claimed that the severance tax discriminated against interstate commerce because ninety percent of the Mon-

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162. BT Inv. Managers, Inc. v. Lewis, 461 F. Supp. 1187, 1196 (N.D. Fla. 1978) (quoting City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)) (emphasis in original).

163. *See* Reeves, Inc. v. Stake, 447 U.S. 429 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976). In these cases the state itself had entered the market in a proprietary fashion. For a discussion of the market-entry exemption, see Blumstein, *supra* note 80, at 533-41; Comment, *Commerce Clause Immunity for State Proprietary Activities,* 4 HARV. J.L. & PUB. POL. 365 (1981).

164. South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938).

165. Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429 (1978).

166. Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945).

167. Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959).

168. Brotherhood of Locomotive Firemen v. Chicago, R.I. & Pac. R.R., 393 U.S. 129 (1968).

169. *See* Mintz v. Baldwin, 289 U.S. 346 (1933); Price v. Illinois, 238 U.S. 446 (1915); Asbell v. Kansas, 209 U.S. 251 (1908); Crossman v. Lurman, 192 U.S. 189 (1904).

170. Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978); Complete Auto Transit v. Brady, 430 U.S. 274 (1977).

tana coal was sold to out-of-state consumers, which effectively shifted the tax burden to non-Montana residents.[171] The Court, however, cited a long line of authority, including *Heisler,* in rejecting plaintiffs' discrimination challenge and, in effect, held that a state could export its tax burden to out-of-state consumers provided that the exporting state did not charge the nonresidents a higher tax rate than it charged residents.[172]

The degree to which either local or out-of-state parties shoulder the burden of the tax is determined according to the amount of value of the resources extracted or produced, or if the tax is shifted forward to consumers, according to the amount consumed. The majority dismissed the taxpayers' assertion that Montana may not "exploit" its "monopoly" position by exporting tax burdens to other states.[173] The Court held that this assertion "cannot rest on a claim that there is need to protect the out-of-state consumers of Montana coal from discriminatory tax treatment. . . . [T]here is no real discrimination in this case; the tax burden is borne according to the amount of coal consumed and not according to any distinction between in-state and out-of-state consumers."[174] The Court continued,

> Nor do we share appellants' apparent view that the Commerce Clause injects principles of antitrust law into the relations between the States by reference to such imprecise standards as whether one State is "exploiting" its "monopoly" position with respect to a natural resource when the flow of commerce among them is not otherwise impeded. The threshhold questions whether a State enjoys a "monopoly" position and whether the tax burden is shifted out of state, rather than borne by in-state producers and consumers, would require complex factual inquiries about such issues as elasticity of demand for the product and alternate sources of supply. Moreover, under this approach, the constitutionality of a state tax could well turn on whether the in-state producer is able, through sales contracts or otherwise, to shift the burden of

171. 453 U.S. 609, 617-18 (1981). *See supra* notes 110-16 and accompanying text.

172. *Id.* at 618-19. The Court noted that ". . . to accept appellants' theory and invalidate the Montana tax solely because most of Montana's coal is shipped across the very state borders that ordinarily are to be considered irrelevant would require a significant and . . . unwarranted departure from the rationale of our prior discrimination cases." *Id.* at 619.

173. *Id.*

174. *Id.* The dissent disagreed with the majority's view that tax exporting is not relevant for purposes of determining the constitutionality of a tax. Justice Blackmun, in dissent, stated:

> "Like a toll gate lying athwart a train route, a severance or processing tax conditions access to natural resources." [citation omitted] Thus, to the extent that the taxing jurisdiction approaches a monopoly position in the mineral, and consumption is largely outside the State, such taxes are "[e]conomically and politically analogous to transportation taxes exploiting geographical position." [citation omitted]

Id. at 650 (Blackmun, J., dissenting).

the tax forward to its out-of-state customers.[175]

Even if a court attempted to balance state and federal interests, it could nevertheless uphold a tax on energy resources. Producing states, after all, have a legitimate interest in protecting their resources from depletion. This interest probably would outweigh the federal government's interest in the free flow of commerce, even if the federal interest were affected substantially. The states, however, could not prohibit the flow of a resource from the state. Such a prohibition would establish a barrier to trade and, thus, be unconstitutional.[176]

Although the states' interest in protecting their resources remains relatively constant, the federal interest varies. In times of surplus energy, low demand, and a sluggish economy, the state interest is likely to supersede the federal interest, even when the two are in apparent conflict. Of course, the balance could shift if the federal government actively promoted its policy of developing alternative energy resources and encouraging domestic production of fuel.

4. Fair Relation Between the Tax and the Services Provided by the State

The fair relation requirement presents the question whether interstate commerce is paying more than its fair share of the tax burden in view of the "benefits of a trained work force and the advantages of a civilized society"[177] that the state offers to an interstate business. The test is one of nexus and apportionment.[178] Thus, the fair relation criterion has little independent existence. Courts do not use a quantitative test to determine fair share. In general, courts uphold a tax that only roughly approximates the

175. *Id.* at 619-20 n.8.

176. *See, e.g.,* New England Power Co. v. New Hampshire, 102 S. Ct. 1096 (1982) (New Hampshire statute empowering the state public utilities commission to prohibit the exportation of hydroelectric energy out of state held unconstitutional); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (New Jersey statute prohibiting the importation of out-of-state solid and liquid wastes to protect state sanitary landfills held unconstitutional); West v. Kansas Natural Gas Co., 221 U.S. 229 (1911) (Oklahoma statute held unconstitutional because it prohibited the shipment of natural gas out of state).

177. Japan Line v. County of Los Angeles, 441 U.S. 434, 445 (1979).

178. Until *Commonwealth Edison,* the Supreme Court had not addressed the elements of the fourth prong of the *Complete Auto Transit* test. The Court in Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978), rejected a challenge under the fair relation test because of a lack of evidence in the record to support the contention. *See* P. HARTMAN, *supra* note 12, § 2:24 (Supp. 1982).

value of the services rendered by the state. The proceeds from the tax need not defray expenses generated by the local activities of the multistate business. Thus, in *Commonwealth Edison* the Supreme Court stated that "complex factual inquiries" into what costs the state incurs to provide the benefits of a civilized society are beyond a court's expertise.[179] The relevant test is not "the *amount* of the tax or the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities."[180] Rather, the test is whether "the *measure* of the tax must be reasonably related to the extent of the [taxpayer's] contact [with the State], since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of state tax burden.' "[181]

Some commentators argue that courts should interpret the test differently.[182] For example, in user charge cases courts have examined fair relation in great detail and balanced the rate of the tax with the activities of the business within the state.[183] The dissenting opinion in *Commonwealth Edison* supports this view and notes that "complex factual inquiries" should be made as a "threshhold inquiry" and are not "beyond judicial competence."[184]

B. Due Process Clause

The due process clause of the fourteenth amendment[185] also is a limitation on the state taxing power. In general, the due process clause prohibits the imposition of taxes upon an out-of-state taxpayer with insufficient connections with the taxing state. "To pass due process clause muster, the event taxed must bear a rational relationship to the taxing state."[186] In addition, the due process clause requires fair apportionment of the tax to the taxpayer's ac-

179. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 619-20 n.8 (1981).

180. *Id.* at 625 (emphasis in original).

181. *Id.* at 626 (quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

182. *See e.g.*, Hellerstein, *Constitutional Constraints on State and Local Taxation of Energy Resources*, 31 NAT'L TAX J. 245, 249-50 (1978).

183. *See* Evansville-Vanderburgh Airport Authority Dist. v. Delta Airlines, 405 U.S. 707, 712-13 (1972); Capitol Greyhound Lines v. Brice, 339 U.S. 542, 545 (1950); California v. Thompson, 313 U.S. 109, 112 (1941).

184. Commonwealth Edison Co. v. Montana, 453 U.S. at 651 (Blackmun, J., dissenting).

185. U.S. CONST. amend. XIV.

186. P. HARTMAN, *supra* note 12, § 2:3, at 19; *see* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978); Norfolk & W.R. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 324-25 (1968); American Oil Co. v. Neill, 380 U.S. 451, 458 (1965).

tivities within the state.[187] These two requirements overlap the nexus and apportionment criteria under the commerce clause.[188] Courts utilize rather lenient standards to determine whether these requirements have been met.[189] Minimal contacts, such as one employee in the state, are sufficient to establish nexus.[190] The apportionment requirement does not impose a limit on the amount of an otherwise lawful tax; rather, the tax is valid if it is apportioned fairly to the taxpayer's activities within the state.[191] Thus, state taxing schemes that raise the most controversy under the due process clause are those that are questionable under the commerce clause—taxes imposed on the instrumentalities of interstate commerce.

The limitations of the due process and commerce clauses are not coextensive. The commerce clause only limits state taxes affecting interstate commerce. If Congress has given states exclusive rights to tax, as in the case of insurance,[192] the commerce clause does not impose a limitation on the tax; the due process clause, however, remains a limitation on the tax.[193] Until recently, courts had held few energy taxes to be violative of the due process clause.[194]

In *Commonwealth Edison v. Montana,* however, the Court offered dictum that a severance tax "may be judicially disapproved" if it amounts to the " 'confiscation of property.' "[195] Thus, if the severance tax were 100% rather than 30%, a valid due process

187. *See* Norfolk & W.R. Co. v. Missouri State Tax Comm'n, 390 U.S. 317 (1968); P. HARTMAN, *supra* note 12, § 2:3, at 19-20.

188. *See* National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 (1967); Ott v. Mississippi Valley Barge Line, 336 U.S. 169, 174 (1949).

189. *See, e.g.,* City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974); A. Magnano Co. v. Hamilton, 292 U.S. 40 (1934); Alaska Fish Salting & By-Products Co. v. Smith, 255 U.S. 44 (1921).

190. *See supra* notes 123-28 and accompanying text. *But see* Miller Bros. v. Maryland, 347 U.S. 340 (1954) (Maryland could not compel a Delaware vendor to collect taxes on sales made to Maryland residents because the due process clause requires more contacts with the state than simply advertising, delivery of goods, and occasional mailing of circulars by a business.).

191. P. HARTMAN, *supra* note 12, § 2:6.

192. McCarran-Ferguson Act § 2, 15 U.S.C. § 1012 (1976).

193. Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 698 (1981); Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 U.S. 324 (1964); State Bd. of Ins. v. Todd Shipyards Corp., 370 U.S. 451 (1962).

194. In ASARCO, Inc. v. Idaho State Tax Comm'n, 102 S. Ct. 87 (1982), and F.W. Woolworth Co. v. Taxation and Rev. Dep't, 102 S. Ct. 86 (1982), the Court invalidated state income taxes on due process grounds. *See supra* notes 149-54 and accompanying text.

195. Commonwealth Edison Co. v. Montana, 453 U.S. at 627 n.17 (quoting A. Magnano Co. v. Hamilton, 292 U.S. 40, 44 (1934)).

claim might exist. One could also apply a similar rationale to property, income, and excise taxes that are so exorbitant that they constitute an unfair taking of property.[196]

C. The Equal Protection Clause

A court will sustain a tax under the equal protection clause[197] if the court finds that the tax has a legitimate purpose and if the lawmakers reasonably could have believed that the use of the challenged classification would promote that purpose.[198] States generally have great discretion in making classifications in tax statutes. "It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions."[199] Courts take a liberal view of both the rationality of the classification and the legitimacy of the state purpose.[200] The test of rationality is not whether the tax in fact accomplished its purpose, but whether "any state of facts reasonably can be conceived that would sustain it."[201] A tax must be "palpably arbitrary" or invidious to violate the equal protection clause.[202] The test of legitimacy is whether the state purpose is within its authority to regulate, not whether the purpose is wise.[203] If a tax meets the rationality and legitimacy tests, then the state tax can discriminate against out-of-state residents in favor of in-state residents.[204] The Court in *Allied*

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196. *See supra* notes 149-54 & 194 and accompanying text.

197. U.S. CONST. amend. XIV, § 1 ("nor [shall any state] deny to any person within its jurisdiction the equal protection of the laws").

198. *E.g.*, Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981).

199. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1937).

200. *See, e.g.*, Kahn v. Shevin, 416 U.S. 351 (1974) (Court held a Florida statute granting a widow an annual $500 property tax exemption was reasonably designed to further the state policy of cushioning the financial impact of spousal loss upon the gender for whom tbat loss imposes a disproportionately heavy burden); Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973) (Illinois constitutional provision subjecting corporations but not individuals to ad valorem taxes on personalty held reasonable).

201. Allied Stores v. Bowers, 358 U.S. 522, 528 (1959).

202. *Id.* at 527.

203. *See* P. HARTMAN, *supra* note 12, §§ 3:2-3:7.

204. Courts have upheld heavier burdens on nonresidents if more than mere nonresidency is present to justify the classification and even though the justification may arise because of the difference in residency. *See, e.g.*, Baldwin v. Montana Fish and Game Comm'n, 436 U.S. 371 (1978); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976); Metropolitan Casualty Ins. Co. v. Brownell, 294 U.S. 580 (1935). In each of these cases the Court proceeded on the basis that a state's application of a heavier hurden upon nonresident corporations or individuals is not a denial of equal protection if the classification is rationally related to a legitimate state purpose.

Stores v. Bowers[205] summarized the wide breadth of the state's taxing power under the equal protection clause:

> The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to ensure revenue and foster their local interests. . . . The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value. . . . 'To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure.'
>
> But there is a point beyond which the State cannot go without violating the Equal Protection Clause. The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation.'[206]

Because the equal protection clause imposes only a minimal limitation on the state taxing power, a court would uphold a tax on natural resources even if the incidence of the tax fell disproportionately on out-of-state taxpayers.[207] In each of the cases in the *Heisler* trilogy plaintiffs raised a fruitless equal protection claim.

In *Heisler v. Thomas Colliery Co.*[208] plaintiff alleged that imposing a severance tax on anthracite but not on bituminous coal created an arbitrary and unreasonable classification. The Supreme Court concluded that the state had a rational basis for according the coals unequal tax treatment because they differed in their physical properties, in their uses as fuel, and in their alternative uses.[209] Similarly, in *Oliver Iron Mining v. Lord*[210] the Supreme Court likewise rejected the equal protection claim. Plaintiff alleged that the state's occupation tax failed to include within its scope certain mine owners, lessees, and contractors engaged in mining operations and that it discriminated between taxpayers. The Court held that the state had "wide discretion" in selecting the subjects of taxation.[211] Finally, in *Hope Natural Gas Co. v. Hall*[212] the Su-

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205. 358 U.S. 522 (1959).
206. *Id.* at 526-27 (citations omitted).
207. *See supra* text at notes 171-75 and accompanying text.
208. 260 U.S. 245 (1922).
209. *Id.* at 257.
210. 262 U.S. 172 (1923).
211. *Id.* at 179.
212. 274 U.S. 284 (1927).

preme Court disposed of an equal protection challenge to an annual privilege tax imposed on mining. The Court stated that "[n]othing indicates a purpose to extend different treatment to those of the same class."[213]

The equal protection argument in taxation cases has become so tenuous that plaintiffs in *Commonwealth Edison* did not even raise the issue. Because of the broad latitude states have in making tax classifications, plaintiffs probably would have failed to sustain an equal protection claim. Nevertheless, an equal protection claim could arise if a state were to substitute natural resource taxes for all other taxes in the state. At oral argument before the Supreme Court in *Commonwealth Edison,* Chief Justice Burger noted that "if all other taxes on all other residents of Montana were repealed and Montanans paid no tax," an equal protection clause problem might exist.[214] In 1981 lawmakers in the Alaska Legislature introduced a bill that would repeal all state income taxes except income taxes on oil and gas companies.[215] Although the legislature never adopted this bill, the legislation illustrates a situation in which an equal protection claim might be successful. The courts have not addressed the question whether a plaintiff successfully could mount an equal protection challenge to an energy tax when reve-

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213. *Id.* at 289.

214. Arguments Before the Court, 49 U.S.L.W. 18, 28 (U.S. July 2, 1981). The following colloquy ensued between Chief Justice Burger, Justice Stevens, and Justice Stewart:

Chief Justice Burger asked:

> Mr. Attorney General, let me put a hypothetical question to you. Suppose the Legislature passed an act declared on its face to be a substitute, in terms of revenue, for all other taxes levied in the state . . . so that the locals would pay no taxes at all, . . . and all the cost of government would be put on one category of taxpayers. Do you think the courts could inquire into that?

And Justice Stevens next inquired:

> Let me just take a step further the question the Chief Justice asked you. Supposing your opponent's assessment is generally correct, that this is an extremely profitable tax in a way for the state, and after you win this case, assuming you do, you then reassess your budgetary considerations and decide you don't need any other taxes at all, you repeal all your other taxes and leave your present tax standing in effect. Would that raise any constitutional question in your judgment?

The Chief Justice queried further:

> Then add to my hypothetical what Mr. Justice Stevens suggested, that all other taxes on all other residents of Montana were repealed and Montanans paid no tax and all the tax was thrust upon five companies or six companies engaged in extracting coal and oil. Any judicial inquiry then, on any clause?

Justice Stewart intimated:

> [Y]ou might have an Equal Protection Clause problem.

Id.

215. *See* H.R.B. 7, 1981, Alaska.

nue from the tax is disproportionately high as a percentage of total tax revenue in the state. Although the equal protection clause should limit a state's ability to select one class of taxpayer to bear a disproportionate share of the tax burden, the courts are not well equipped to draw such distinctions and to examine various degrees of discrimination. Courts either validate or invalidate a tax. If these taxing trends continue, however, courts may be forced to resolve the issue.

D. *The Privileges and Immunities Clause*

The privileges and immunities clause provides another method to challenge state and local taxes, although its utility is somewhat limited. Article IV of the Constitution provides, "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."[216] The Supreme Court in *Ward v. Maryland*[217] stated that

> this clause plainly and unmistakably secures and protects the right of a citizen of one State to pass into any other State of the Union for the purpose of engaging in lawful commerce, trade, or business without molestation; to acquire personal property; to take and hold real estate; to maintain actions in the courts of the State; and to be exempt *from any higher taxes or excises than are imposed by the State upon its own citizens.*[218]

The privileges and immunities clause, however, protects only individuals, not corporations.[219] Therefore, under this provision courts may not invalidate taxing schemes that burden oil and gas or coal companies. Moreover, severance taxes have not been subjected to any privileges and immunities claims since usually only corporations are involved in resource extraction.[220] Courts, however, have invalidated a number of excise taxes under this clause, including the imposition of greater license fees on nonresident fishermen[221] and owners of boats[222] than on resident fishermen and resident owners of boats. Similarly, the Court has struck down taxes on out-of-state construction firms[223] and vendors[224] that were greater than

216. U.S. CONST. art. IV, § 2.

217. 79 U.S. (12 Wall.) 418 (1870).

218. *Id.* at 430 (emphasis added).

219. Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869). For a criticism of this limitation on the reach of the privileges and immunities clause, see Eule, *supra* note 80, at 449-54.

220. Further, severance taxes usually do not distinguish between residents and nonresidents.

221. Mullaney v. Anderson, 342 U.S. 415 (1952).

222. Toomer v. Witsell, 334 U.S. 385 (1948).

223. Chalker v. Birmingham & N.W. Ry., 249 U.S. 522 (1919).

224. Ward v. Maryland, 79 U.S. (12 Wall.) 418 (1870).

the taxes on in-state construction firms and vendors.[225]

E. Supremacy Clause

The supremacy clause[226] also may limit the power of states, in certain instances, to impose taxes. This clause applies not only to situations in which a congressional act or a constitutional provision conflicts with state law, but also to situations in which no federal enactment or constitutional provision expressly preempts state action, federal legislative or constitutional scheme "announces, or is best understood as implying, a congressional purpose to 'occupy the field.' "[227] A court will examine the policies, objectives, and comprehensiveness of the federal regulatory scheme to determine whether Congress intended to exercise exclusive control over a matter.[228]

Three recent Supreme Court cases have addressed the effect of certain congressional legislation on state taxes of energy. In *Arizona Public Service Co. v. Snead*[229] the Supreme Court addressed the constitutionality of a New Mexico tax on the generation of electricity within the state for the purpose of sale.[230] New Mexico provided a credit against its gross receipts tax for any generation tax paid to New Mexico or to any neighboring state.[231] Thus, any person who generated electricity in New Mexico for intrastate sale in effect paid no generation tax. The Supreme Court held that this

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225. Another limitation on the reach of the privileges and immunities clause is the Court's holding in Baldwin v. Fish & Game Comm'n, 436 U.S. 371 (1978). In *Baldwin* the Court stated: "Only with respect to those 'privileges' and 'immunities' bearing upon the vitality of the Nation as a single entity must the State treat all citizens, resident and nonresident, equally." *Id.* at 383 (recreational elk hunting held not to be within this category of rights). This requirement, however, should not limit, by itself, the application of the clause in the state taxing context if those rights are construed to include "all the privileges of trade and commerce." *Id.* at 394 (Burger, C.J., concurring); *see* Hicklin v. Orbeck, 437 U.S. 518, 524 (1978).

226. U.S. CONST. art. V, cl. 2 provides that the Constitution and laws of the United States "shall he the supreme Law of the Land . . . any Thing in the Coustitution or Laws of any State to the Contrary notwithstanding."

227. L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-23, at 377 (1978); *see* Note, *The Preemption Doctrine: Shifting Perspective on Federalism and The Burger Court,* 75 COLUM. L. REV. 623 (1975); Note, *Pre-emption as a Preferential Ground: A New Canon of Construction,* 12 STAN. L. REV. 208 (1959); Note, *A Framework for Preemption Analysis,* 88 YALE L.J. 363 (1978).

228. *See, e.g.,* Askew v. American Waterways Operations, Inc., 411 U.S. 325 (1973); Castle v. Hayes Freight Lines, 348 U.S. 61 (1954).

229. 441 U.S. 141 (1979).

230. N.M. STAT. ANN. § 7-18-3 (1978) (repealed 1982).

231. *Id.* § 7-9-80 (1978).

taxing scheme was contrary to the Tax Reform Act of 1976,[232] by which Congress intended to prohibit electricity generation or transmission taxes that discriminated against out-of-state consumers.[233]

Similarly, in *Maryland v. Louisiana*[234] the Supreme Court addressed the constitutionality of Louisiana's first use tax on natural gas passing through the state.[235] The tax statute required that the tax should "be deemed a cost associated with uses made by the owner in preparation of marketing of the natural gas."[236] In addition, the statute prohibited any attempt to allocate the cost of the tax to any party except the ultimate consumer.[237] Thus, the tax, in effect, burdened only out-of-state consumers.[238] In addition to finding that the tax unconstitutionally discriminated against interstate commerce, the Court held that the Natural Gas Act,[239] which was intended "to assure that consumers of natural gas received a fair price and also to protect against the economic power of the interstate pipelines,"[240] preempted the tax. Congress adopted the Natural Gas Act to prevent the states from directly or indirectly regulating the price of gas sold "to regulate the wholesale pricing of natural gas in the flow of interstate commerce from wellhead to delivery to consumers."[241] The Court held that "[t]he effect of [the tax was] to interfere with [the federal government's] authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers."[242] Like the Tax Reform Act in *Arizona Public Service,* the Natural Gas Act and its regulations demonstrated a clear congressional intent to preempt the state tax.[243] In *Maryland v. Louisiana* Congress intended to subject natural gas to uniform rates and regulations.

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232. 15 U.S.C. § 391 (1976 & Supp. 1980).
233. Arizona Pub. Serv. Co. v. Snead, 441 U.S. at 149.
234. 451 U.S. 725 (1981).
235. LA. REV. STAT. ANN. § 47:1303(C) (West Supp. 1982).
236. *Id.*
237. *Id.*
238. The combination of a myriad of exemptions and tax credits for Louisiana users and the purported allocation of the cost of the tax resulted in a tax only on gas moving out of state. Maryland v. Louisiana, 451 U.S. at 733.
239. 15 U.S.C. § 717 (1976).
240. 451 U.S. at 747-48.
241. *Id.* at 748.
242. *Id.* at 749.
243. Even in cases in which a direct conflict exists between a federal statute and a state statute, interpretations of the statute or regulations and examination of the legislative history are necessary before a court will conclude that Congress intended to preempt a state enactment. *See* L. TRIBE, *supra* note 129, § 6-24.

Maryland v. Louisiana illustrates the distinction that courts often draw between purely revenue raising measures and price control schemes. In the former the tax likely will overcome a preemption challenge because one reasonably could expect that taxes will increase the costs on the taxed person, property, or activity. In the latter a court likely will find the tax to be a substantive regulation that could be outweighed by a federal interest.

In contrast to *Arizona Public Service* and *Maryland v. Louisiana,* the Court in *Commonwealth Edison* found no clear federal policy to preempt the Montana severance tax on low-sulfur coal. Plaintiffs argued that the severance tax substantially frustrated and impaired the national policy goal, reflected in ten federal statutes, of fostering the use and production of low sulfur coal.[244] The Supreme Court rejected the suggestion that Congress intended to preempt all state legislation that may have an adverse impact on the use of coal and held that general national policy did not preempt the severance tax.[245] The Court noted that it had to consider the "specific federal statutes with which the state law is claimed to conflict."[246] After examination of the statutes the Court concluded that rather than being in conflict with these federal statutes, the severance tax was implicitly authorized by them.[247]

Thus, "clear" conflict must exist between a state tax and a federal statute for the federal enactment to preempt the state tax. Courts are more likely to strike down a regulatory tax than a revenue raising tax. In particular, taxes that attempt to regulate the price of oil, gas, or other natural resources and are the subject of a federal law are most likely to be overturned.[248]

244. *See* Power Plant and Industrial Fuel and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289 (1978); Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (1978); Energy Conservation and Production Act, Pub. L. No. 94-385, 90 Stat. 1125 (1976); Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 871 (1975); Federal Nonnuclear Energy Research and Development Act of 1974, Pub. L. No. 93-577, 88 Stat. 1878 (1974); Energy Reorganization Act of 1974, Pub. L. No. 93-438, 88 Stat. 1233 (1974); Energy Supply and Environmental Coordination Act of 1974, Pub. L. No. 93-319, 88 Stat. 246 (1974); Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-158, 87 Stat. 627 (1973); Clean Air Amendments of 1970, Pub. L. No. 91-604, 84 Stat. 1676 (1970).

245. 453 U.S. 609, 633-36 (1981).

246. *Id.* at 634.

247. *Id.* at 636; *see supra* note 122.

248. *See* Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978) (rejecting contention that broad, general national policy can preempt state laws that have an indirect economic effect upon that policy). In McGoldrick v. Gulf Oil Corp., 309 U.S. 414 (1939), the Court struck down a state tax on imported fuel oil. At the time of the suit, § 30 of the Revenue Act of 1932 provided "that no tax nnder § 601 shall be laid 'upon any article sold

IV. THE CONSUMING STATES' DILEMMA

As part III of this Article demonstrates, energy-producing states have wide latitude under the Constitution in fashioning taxes on energy resources. Except in extreme cases, these taxing schemes will survive constitutional challenge. Unless the Court dramatically alters its current interpretation of the Constitution,[249] the burden of these taxes will continue to fall on the consuming states. The growing fiscal disparity[250] between the consuming states and the energy-rich states is likely to have substantial social and political consequences as well. A shift in population to these producing states is occurring and with it a shift in political influence.[251]

To prevent this growing fiscal disparity with all its attendant consequences, the consuming states must resort to measures other than constitutional limitations. Already, some states have attempted to retaliate against energy-producing states by imposing their own taxing schemes.[252] In addition, consuming states are advocating federal legislation that would limit the ability of producing states to impose severance taxes.[253] This Article now examines how energy-consuming states are retaliating against the energy-producing states. Following the discussion of the retaliation issue, the Article explores alternatives and solutions to a potential energy conflict between the states. The Article focuses on three "solutions." First, Congress could devise federal revenue sharing plans to reduce the disparity, although these plans are complicated and often not politically feasible. Second, a state compact or agreement limiting these taxes is an ideal solution if the states can reach a

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for use as fuel supplies, ship's stores . . . on vessels . . . actually engaged in foreign trade . . . .'" *Id.* at 424. The Court held that the state tax must fall because

> [t]he Congressional regulation, read in the light of its purpose, is tantamount to a declaration that in order to accomplish constitutionally permissible ends, the imported merchandise shall not become a part of the common mass of taxable property within the stato, pending its disposition as ships' stores and shall not become subject to the state taxing power. . . . The state tax in the circumstances must fail as an *infringement of the Congressional regulation of the commerce.*

309 U.S. at 429 (emphasis added).

249. The Supreme Court, for example, could require a quantitative approach to the fair relation and apportionment questions. *See* Hellerstein, *supra* note 182.

250. *See* P. Cuciti, *supra* note 9, at 58. Disparities in fiscal capacity have grown by 45% since 1967 and by 111% since 1975.

251. *Id.* at 12-13. *See* P. Mieszkowski & E. Toder, *supra* note 5, at 30-39 (discussion of location choice and distribution of economic rents).

252. *See infra* notes 255-56.

253. *See infra* note 268.

consensus. Last, the consuming states could develop their own resources and become energy independent.

A. *Retaliation*

Some energy-consuming states in the northeast have enacted retaliatory taxing schemes in an attempt to reap some of the large amounts of revenues generated from energy production.[254] For example, some states have levied excise taxes on oil and gas companies. In 1980 both New York[255] and Connecticut[256] enacted gross receipts taxes on oil and gas companies based on the sale of oil and gas within the state. The New York statute prevented[257] and the Connecticut statute limited[258] the passthrough of the tax costs to consumers. Federal district courts in *Mobil Oil Corp. v. Tully*[259] and *Mobil Oil Corp. v. Dubno*,[260] however, struck down both taxes on preemption grounds. Both courts concluded that the antipassthrough provisions conflicted with federal legislation that regulated the pricing of petroleum products. According to the courts, one of the purposes of the Emergency Petroleum Allocation Act was to assure fair and equitable oil and gas prices among all regions of the United States and to permit local taxes on these resources to be passed through to consumers.[261] The *Dubno* court noted that the taxing statute stood as "an obstacle to the accomplishment and execution of the full purpose and objectives of Congress" as to fed-

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254. "Retaliatery taxes" is the label this Article gives to state taxes that have an incidence largely on out-of-state taxpayers. The courts have used retaliation in a different way. *See e.g.*, Western & Southern Life Insurance Co. v. State Board of Equalization, 451 U.S. 648 (1981).

255. N.Y. TAX LAW § 182 (Consol. 1980).

256. CONN. GEN. STAT. ANN. § 12-599 (West Supp. 1981).

257. N.Y. TAX LAW § 182(11)(a) provides as follows: "[T]he tax imposed hy this section and any penalty which may be assessed under this subdivision shall be a liahility of the oil company, shall he paid by such company and shall not be included, directly or indirectly, in the sales price of its products sold in this state."

258. CONN. GEN. STAT. ANN. § 12-599(b) provides as follows:

> No petroleum company subject to the tax imposed under section 12-587 of this act shall raise its posted wholesale rack price in Connecticut for any petroleum product exempt from the Federal Emergency Petroleum Allocation Act (P.L. 93-159) hy an amount higher than the average amount by which such company raises its wholesale rack price for such product in all ports on the eastern coast of the United States.

259. 499 F. Supp. 888 (N.D.N.Y. 1980), *appeal dismissed in part*, 639 F.2d 912 (2d Cir.), *aff'd*, 653 F.2d 497 (Temp. Emer. Ct. App.), *cert. denied*, 452 U.S. 967 (1981).

260. 492 F. Supp. 1004 (D. Conn. 1980), *appeal dismissed in part and aff'd in part*, 639 F.2d 919 (2d Cir.), *cert. denied*, 452 U.S. 967 (1981).

261. Mobil Oil Corp. v. Tully, 499 F. Supp. 888, 899 (N.D.N.Y. 1980); Mobil Oil Corp. v. Dubno, 492 F. Supp. 1004, 1006 (D. Conn. 1980).

eral price control.[262] Through the taxes the states were attempting to insulate their citizens from the impact of the local taxes, and, in effect, to regulate prices. Consuming states with downstream operations of oil companies largely have been unsuccessful in their efforts to reap significant portions of energy revenues.[263] Energy-consuming states now are considering joint efforts to coordinate regional taxation of energy revenues.[264]

Another method to retaliate against energy-producing states is a tax on railroads, pipelines, trucks, and port facilities that are involved in the transportation of the oil, gas, or coal from its source to consumers. The utility of this type of retaliatory tax is limited. First, only those states abutting the producing states or having port facilities are able to retaliate. Second, the commerce clause limits taxation of the instrumentalities of interstate commerce.[265] While railroads, trucks, pipelines, and port facilities must shoulder their fair share of the tax burden, the commerce clause prohibits unduly burdensome taxes.[266] Thus, a state cannot impose retaliatory taxes on these instrumentalities.

A third method for the consuming states to retaliate is to levy severance taxes or other taxes, the incidence of which falls on energy-rich states. Like the two types of retaliation discussed above, this tactic also has its limits. First, to be effective, the states imposing the tax must have a monopoly on the taxed goods or services. Second, even if such a monopoly position exists, energy-rich states may not be the only states affected by such a tax. For example, a tax on gambling or tourism would affect consumers from all states.

In summary, the opportunity for consuming states to retaliate specifically against energy-rich states is limited both constitutionally and practically. Both the supremacy and commerce clauses present significant barriers to retaliatory taxes that would burden interstate commerce or interfere with federal price controls of oil or gas. Moreover, not all states have the resources to retaliate effectively. Thus, the taxing schemes could fail and cause businesses to leave the state.

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262. 499 F. Supp. at 906; 492 F. Supp. at 1014 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

263. BUSINESS WEEK, Oct. 26, 1981, at 170, col. 3.

264. *Id.*

265. *See* California v. Thompson, 313 U.S. 109 (1941); Ingels v. Morf, 300 U.S. 290 (1937); P. HARTMAN, *supra* note 12, § 2:6.

266. C. McClure, Tax Exporting, *supra* note 8, at 17.

B. *Congressional Intervention*

A court has only two options when presented with a challenge to a taxing scheme. It either can strike down the tax and leave the state powerless to utilize that tax to raise needed revenue, or it can let the tax stand. A court cannot follow a middle ground and fashion a new tax or limit the reach of an existing tax. Congress, on the other hand, has numerous options available to it to solve the problems caused by state taxation of natural resources. Congress can limit the state tax, prohibit the tax from being passed on to consumers, provide federal tax deductions to offset the tax, or pass legislation giving the states an incentive to reduce their taxes.[267]

The rates of severance taxes on coal thus far have caused the greatest controversy. Several bills have been introduced in Congress to limit the rate of these taxes on coal both on federal and nonfederal land.[268] Congress unquestionably has the constitutional power to limit severance taxes on both federal and state lands. Consequently, if Congress determined that a severance tax would frustrate a national energy policy—for example, providing low sulfur coal for the energy needs of the nation—it constitutionally could adopt legislation to limit the tax. Congress has acted before in the energy area to further the free flow of energy and to limit state taxing schemes.[269]

Before deciding to intervene, however, Congress must consider the form that a statute should take. What limit should be placed on these taxes, and should the taxes be limited only to the severance taxes on coal? To the first question, no one would disagree that the states should be allowed to tax enough to cover the costs of the energy exploitation. These costs—social, economic, environmental, and psychological—are not easy to determine. Studies could estimate with reasonable accuracy the decrease in the quality

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267. Congress has not extended its protection and control to the field of [state] taxation, although I take it no one denies that constitutionally it may do so. It may exact a single uniform federal tax on the property or the business to the exclusion of taxation by the states. It may subject the vehicles or other incidents to any type of state and local taxation, or it may declare them tax-free altogether.

Northwest Airlines v. Minnesota, 322 U.S. 292, 303-04 (1944) (Jackson, J., concurring).

268. *See, e.g.*, S. 178, 97th Cong., 1st Sess. (1981); S. 2695, 96th Cong., 2d Sess. (1980); H.R. 7163, 96th Cong., 2d Sess. (1980); H.R. 6654, 96th Cong., 2d Sess. (1980); H.R. 6625, 96th Cong., 2d Sess. (1980); H.R. 5294, 96th Cong., 2d Sess. (1980).

269. For example, the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, § 311(a)(2)(A)(i), 92 Stat. 3350, 3388-89 (1978), granted the Federal Energy Regulatory Commission power to authorize any intrastate pipeline company to transport gas for interstate pipeline travel.

and quantity of the water supply, the amount of air pollution, and the increased demand for public transportation, road construction and maintenance, public services, sewage treatment, school teachers, and police and fire protection. A greater difficulty exists in computing the cost of depletion of nonrenewable natural resources, or the psychological damage and aesthetic consequences of energy exploitation.[270]

Along with the problem of determining the state's fair share of the tax revenues, Congress must determine whether only severance taxes or all energy resource taxes should be limited. If Congress were to place a limit on severance taxes alone, the states easily could increase other energy taxes, the incidence of which falls on out-of-state consumers. States could utilize any one of these other types of taxes to accomplish the same result as a severance tax. Montana, for example, has a license tax on mineral production,[271] a corporation license tax,[272] a mining property tax,[273] a mining equipment tax,[274] and a coal retailer's license tax[275] in addition to a severance tax. Furthermore, singling out coal rather than oil and gas for taxation may not be equitable.

Even if Congress could resolve all the problems concerning the form and content of federal legislation limiting state resource taxes, serious problems in passing such legislation still would exist. Interference with a state's authority to tax is politically sensitive. In addition, limiting energy taxes could be a precedent for limiting other taxes.

C. *Revenue Sharing*

One possible solution to the growing fiscal disparities between energy-consuming and energy-producing states would be to establish a federal revenue sharing scheme that would transfer to the energy-consuming states some of the wealth taken by the energy-producing states. Revenue sharing is not new to United States

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270. *See Coal Severance Tax: Hearing on S. 2695 Before the Senate Comm. on Energy and Natural Resources*, 96th Cong., 2d Sess. (1980); *Coal Severance Taxes: Hearings on H.R. 6625, H.R. 6654, and H.R. 7163 Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 2d Sess. (1980).

271. The tax is 1.438% of annual gross value of product at the time of extraction, if such total exceeds $5,000. MONT. CODE ANN. § 15-37-103 (1981).

272. *Id.* § 15-31-121(1) (tax is 6.75% of taxable net income).

273. *Id.* (tax is 45% of assessed value, which is defined as 100% of annual gross proceeds).

274. *Id.* § 15-6-138 (tax is 11% of market value).

275. *Id.* (tax is $.05 per ton sold).

fiscal policy. The federal government has long had various measures for transferring fiscal resources from rich to poor states. Traditionally, federal assistance to state and local governments has taken four forms: (1) categorical grants-in-aid directly related to narrow purposes as defined by Congress and administered with tight grantor control; (2) block grants structured to consolidate narrow categorical grants but with broader grantee discretion and less grantor control; (3) intergovernmental loans; and (4) general revenue sharing of federal funds with few restrictions.[276] The State and Local Fiscal Assistance Act of 1972[277] controls general revenue sharing schemes. Under this act federal funds are distributed to states based on a formula that includes population, tax effort, and per capita income.[278] This allocation scheme, however, favors energy producing states because a state tax effort includes severance and other taxes on energy resources, the incidence of which falls on taxpayers outside of the state. Furthermore, no energy revenues specifically are recycled under this system.[279] Only federal funds taken from all taxpayers are redistributed.

Any transfer system utilizing the redistribution of energy resources would have several problems. First, the problem exists of defining what energy sources would be covered—coal, oil, gas, geothermal, hydroelectric, or nuclear, to name a few. Second, the problem arises of determining what revenues should be recycled—severance tax revenues from federal lands, all severance tax revenues, all energy tax revenues, and royalties and lease payments from federal lands. Third, the transfer system would raise the question of why energy revenues alone should be singled out; why not revenues from timber, crops, and other mineral resources?

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276. *See* Amyx, *New Federalism: How is it Working?*, 15 WASHBURN L.J. 229, 230 (1976); Brown, *Federal Funds and National Supremacy: The Role of State Legislatures in Federal Grant Programs*, 28 AM. U.L. REV. 279, 279 n.3 (1979).

277. 31 U.S.C. §§ 1221-65 (1976).

278. *Id.* § 1225.

279. In Canada, where the beginning of regional energy disputes is apparent, the government uses an equalization formula to recycle federal money to poor provinces. This formula takes into account all revenue resource capabilities of the province—taxes as well as royalty revenues, lotteries, and other revenue sources. A national average revenue amount is calculated based on the population of each province. The federal government then transfers general federal revenues to those states that are below average. Resource revenues are equalized only to one half of the national average. Total equalization among the provinces does not occur under this system because no money is taken from the richer provinces. *See* J. Whyte, A Constitutional Perspective on Federal Provincial Sharing of Revenues From Natural Resources (unpublished paper); Kwon, *Revenue Sharing as an Improvement in Provincial-Municipal Relations in Canada: An Evaluation of Saskatchewan Revenue Sharing*, 27 CAN. TAX. J. 576 (1979).

In addition, the question of administrative feasibility persists. Like the present revenue sharing plan, a comprehensive transfer system would require complicated definitions and calculations in making any allocations. Last, the political feasibility of such a plan presents a problem. With budget cuts and the "new federalism," a new program that would require an increased federal bureaucracy, which would be difficult politically to establish.[280] As an alternative to a sharing plan based on energy revenues, the present system could be modified. A modified system could exclude from the formula a portion or all of a state's energy taxes borne by those out of state.[281] Thus, in determining the amount of federal revenues to be shared with energy-rich states, the formula would give no consideration to revenues generated from energy taxes whose incidence fell on out-of-state consumers.

D. Cooperation

Perhaps the best solution to the fiscal disparity and tax retaliation problem between consuming and producing states would be the negotiation of a compact.[282] Precedent exists for such an agreement in the Multistate Tax Compact.[283] Thirty-two states and the District of Columbia have signed this agreement limiting state and local taxation of business firms engaged in interstate commerce.[284]

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280. From an economic efficiency point of view, such a system would be an incentive for the energy-producing states to lower their taxes.

281. This proposal, like the legislative proposals discussed above, could raise the following questions: (1) Should all or only a part of a state's energy taxes be excluded from the federal revenue sharing formula? (2) If some energy taxes are excluded from revenue sharing, then which ones—coal, oil, and gas taxes? (3) What is the incidence of these taxes? (4) Should all taxes that burden persons out-of-state be excluded from the revenue sharing formula?

282. Although article I, § 10 of the U.S. Constitution states that "[n]o state shall, without the Consent of Congress, . . . enter into any Agreement or Compact with another state," the Supreme Court throughout its history has refused to apply this provision literally. The Court held in Virginia v. Tennessee, 148 U.S. 503, 519 (1893), that this provision was directed only "to the formation of any combination tending to the increase of political power in the States, which may encroach upon . . . the just supremacy of the United States." *See* Engdahl, *Characterization of Interstate Arrangements: When is a Compact not a Compact*, 64 MICH. L. REV. 63, 69-73 (1965).

283. *See* ALL STATES TAX GUIDE (P-H) ¶¶ 551-556 (1981).

284. The following are parties: Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, Washington, and West Virginia. The following states are associate member states: Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, Ohio, Oklahoma, Pennsylvania, Tennessee, and Virginia. Associate member states have all the rights of Commission members, except the right to vote or to hold a Commission office. *Id.* ¶¶ 564-565.

The purposes of the Compact are many: (1) to promote uniformity in the taxation of multistate business; (2) to avoid duplication in taxation of that business; (3) to facilitate taxpayer convenience and compliance in filing tax returns; and (4) to help multistate businesses in the determination of their state and local tax liabilities.[285] The Compact addresses income, capital stock, gross receipts, sales, and use taxes, although it provides for study and recommendations of other types of state and local taxes.[286] Under the Compact taxpayers may elect to allocate and apportion income for income tax purposes under the Uniform Division of Income for Tax Purposes Act (UDITPA).[287] The Compact establishes jurisdiction standards for sale and use taxes that require tax collections and payments by vendors who maintain certain connections with the state.[288] The Compact has two significant drawbacks. First, states can withdraw from the Compact at any time.[289] Second, the Compact does not itself prescribe uniform standards. It does, however, set up the procedure and machinery for interstate cooperation in the formulation of such standards. This cooperation, by itself, is a great step forward in any cooperative effort among states.

The states formed the Compact as a direct result of the Supreme Court's failure to restrict constitutionally the states' power to tax. In 1959 the Supreme Court held in *Northwestern States Portland Cement Co. v. Minnesota*[290] that state and local jurisdiction to tax could rest on sales activity of the taxpayer within the jurisdiction even if the taxpayer had no physical property or full-time employees there.[291] Later that same year, the Court refused to

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285. *See id.* ¶ 552.

286. The Commission is the body that conducts research and makes recommendations. "Specifically, the Commission is empowered to (a) study state and local tax systems and particular types of state and local taxes; (b) develop and recommend proposals to increase uniformity or compatibility of state and local tax laws; and (c) compile and publish information that would assist party states in implementing the Compact." *Id.* at 555. In general, the Commission has no authority over party states, but it does have binding authority in the arbitration of an apportionment dispute. The Commission is composed of one member from each party state. *Id.* ¶ 554.

287. *Id.* ¶ 556. For a description of UDITPA, see P. HARTMAN, *supra* note 12, § 9:22.

288. These connections consist of directly or indirectly—by a representative or agent—(1) maintaining an office or place of business; (2) maintaining inventory; (3) soliciting orders; (4) making regular deliveries other than by mail or carrier; and (5) engaging in any activity in connection with leasing or servicing instate property. ALL STATES TAX GUIDE (P-H) ¶ 558 (1981).

289. Florida, Illinois, Indiana, and Wyoming have withdrawn as party states, and New York has withdrawn as an associate member state. *Id.* ¶¶ 564-565.

290. 358 U.S. 450 (1959).

291. *See also* Scripto, Inc. v. Carson, 362 U.S. 207 (1960) (same).

review a state decision that upheld an income tax in which the only activity of the business within the state was solicitation of orders.[292] As a result of these cases, interstate businesses became concerned about the prospect of filing tax returns in numerous states and pressured Congress to limit states' jurisdiction to tax. What followed was the passage of Public Law 86-272.[293] This act precludes states from imposing an income tax on a business when its only activity within the state is the solicitation of orders or the using of an independent contractor to make sales within the state.[294] Since this statute was passed, numerous bills have been introduced in Congress to limit further the states' taxing powers.[295]

Interestingly enough these same types of developments are occurring with severance taxes. The Supreme Court has failed to impose restrictions on the energy producing states' ability to impose taxes that fall largely on consuming states. Consuming states have pressed for passage of legislation that would limit producing states' power to tax natural resources and legislators have introduced numerous bills into Congress to effectuate this purpose.[296] One significant difference, however, exists between multistate business taxation and energy resource taxation. While all states should provide reasonable taxing rules for multistate businesses—since all states have these businesses within their states—only consuming states have an interest in limiting energy taxes. Consequently, in the absence of effective retaliatory measures by the consuming states, the consuming states may be unable to enter into a satisfactory agreement with the producing states because they cannot offer adequate

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292. International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640, *cert. denied,* 359 U.S. 984 (1959).

293. S. 2521, 86tb Cong., 1st Sess. (1959). For a detailed discussion of Public Law 86-272, see P. HARTMAN, *supra* note 12, §§ 9:8-9:14.

294. Another part of the statute directed Congress to make a study and report on state taxation of multistate income. This study's recommendations are reflected in H.R. 11798, 89th Cong., 1st Sess. (1965). This bill required all states to use a federal income tax base, compelled them to allow the use of a two-factor apportionment formula, and mandated a uniform sales and use tax law.

295. *See, e.g.,* H.R. 1538, 92nd Cong., 1st Sess. (1971); H.R. 7906, 91st Cong., 1st Sess. (1969); H.R. 2158, 90th Cong., 2d Sess. (1967). Since 1971 Congress has considered a number of legislative proposals but the bills have died without congressional action. *See* ALL STATES TAX GUIDE (P-H) ¶ 570 (1981).

296. *See, e.g.,* H.R. 1313, 97th Cong., 1st Sess., 127 CONG. REC. H213 (daily ed. Jan. 27, 1981); S. 178, 97th Cong., 1st Sess., 127 CONG. REC. S420 (daily ed. Jan. 21, 1981); S. 2695, 96th Cong., 2d Sess., 126 CONG. REC. S5371 (daily ed. May 14, 1980). *See generally Coal Severance Taxes: Hearings on H.R. 6625, H.R. 6654, and H.R. 7163 Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce,* 96th Cong., 2d Sess. (1980).

consideration. If, however, retaliation continues and is effective, a compact might become more feasible.

E. Energy Independence

The consuming states could narrow the gap with their energy-producing neighbors by becoming producers of energy resources other than coal, oil, and gas.[297] The extent to which a state may become energy independent will depend not only upon the natural resources in that state, but also on the effectiveness of incentive programs instituted by the state to promote the development of these resources. A state that has abundant renewable natural resources, such as hydroelectric power, timber, or corn, may be better able to achieve independence than a state lacking these resources or possessing only a limited amount of nonrenewable resources. Since all states are able to use solar energy, all states have the potential of becoming energy independent.[298] Also, with the development of fusion, energy independence may become more likely.[299]

Renewable energy resources, however, will not become viable alternatives to oil, gas, and coal in the absence of incentive programs. Both federal and state incentives have existed for several years to promote these resources. These incentives have taken the form of direct subsidies through grants and loans and indirect tax subsidies through credits and deductions. The incentive program, however, will take time to work and will remain ineffective as long as oil, gas, and coal are cheaper.

Like the alternatives discussed above, the alternative of energy independence has its problems. But this solution is the best way to solve not only the consuming states' dilemma but also the country's energy problems. When the states become energy independent the country will become energy independent.

V. Conclusion

The fiscal imbalance between the energy-consuming and energy-producing states has not reached its apogee.[300] Although the

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297. These sources include solar, water, wind, geothermal, ocean thermal, wood, hydroelectric, and biomass energy.

298. *See* D. Yergin & R. Stoubaugh, Energy Future 183-215 (1979).

299. Time, Jan. 10, 1983, at 53. While fusion could prove to be an important development, the article notes that experts do not expect an operable commercial fusion reactor until the next century.

300. Producing states argue that the impact of coal severance taxes on a consumer's

consuming states are experiencing a substantial financial drain, the general state of the economy also has had its impact on energy-producing states. The demand for energy has decreased and with it, state revenues. Nevertheless, as the demand for oil, gas, and coal increases and severance and other energy taxes continue to rise, problems of retaliation are bound to proliferate. Moreover, as the conflict between consuming and producing states becomes more intense, the federal government must be prepared to close the gaps between the energy-rich and energy-poor states. The judiciary is the most unlikely branch to offer a solution to a regional energy conflict. Constitutional doctrine as molded by the Supreme Court gives energy-producing states wide latitude in formulating natural resource tax schemes. Thus, the Court appears unwilling to intervene in state taxation conflicts in the absence of congressional action.[301] Congressional action is possible, but the problem persists of how far the federal government should go in limiting a very important area of concern to the states. Perhaps a limitation of severance taxes on resources in federal lands may be appropriate. A state compact limiting energy taxes is unlikely, and even if such a compact were negotiated, problems undoubtedly would exist in getting all the states to agree on exact limits of energy resource taxation. Revenue sharing is the most complicated possible solution to a domestic energy conflict. Such a plan, which would involve federal aid to energy-poor states, does not appear to be in tune with the Reagan administration's "new federalism." Lastly, each state could strive for energy independence, which when accomplished, could solve not only the nation's regional energy problems, but also our national energy problems.

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utility bills is only a few cents per month.

301. *See* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 638 (1981) (White, J., concurring) ("The constitutional authority and machinery to thwart efforts such as those of Montana . . . are available to Congress. . . .").