The Effect and Validity of State Taxation of Energy Resources

James L. Case
Washington University School of Law
THE EFFECT AND VALIDITY OF STATE TAXATION OF ENERGY RESOURCES

I. INTRODUCTION

In its infancy the energy industry was problem ridden. Over production caused deflated prices, waste, and environmental damage. In reaction, the states began to conserve their energy resources. As demand approached supply, producers resisted state control because it depressed profits. At the insistence of the influential oil lobby, state efforts to curb production gave way to federal regulation that favored accelerated production. Although the ever increasing federal regulation of energy divests the states of the largely independent control they

2. "Waste" describes a failure to extract all the mineral from a field.
3. D. Davis, supra note 1, at 45. 49.
7. M. Willrich, Administration of Energy Shortages 252 (1976). The Texas Railroad Commission regulated production, including methods to obtain maximum recovery. Id. at 249. Louisiana stressed full removal and waste avoidance. The experiences of that state demonstrate that conservation and production are synonymous. R. Sullivan, supra note 4, at 110.
once enjoyed, the state struggle to regulate production and distribution of energy resources is continuing.

States often used taxation as a means of regulation. Because energy is often an article of interstate commerce, state regulation affecting it may conflict with federal regulation. This federal-state conflict raises constitutional problems involving the dormant commerce clause and the supremacy clause. The several energy producing states clearly desire: 1) control of the manner and amount of production; 2) compensation for the loss of state wealth associated with the extraction of energy resources; and 3) compensation for environmental damage and other related costs of energy production. This Note explains each of those objectives, applies the objectives to a scheme of taxation, and finally examines the tax in a constitutional context. Part II of the Note examines the goal of controlling production by looking at the New Mexico electricity generation tax and the Oklahoma natural gas production tax. Part III focuses on Louisiana's first use tax on gas as an example of a state attempt to gain compensation for depletion of energy resources. Part IV discusses the third goal of compensation for environmental damage. The Note identifies limitations on states' abilities to tax energy and also identifies means to avoid the limitations. The Note suggests guidelines for tax schemes that affect the control of energy resources.

II. Control of Production

Control of the manner and the amount of production is an affirmation of the ongoing state desire to conserve scarce energy resources and

9. The Texas Railroad Commission possessed comprehensive authority to control the oil industry in Texas. The Commission fixed rates and regulated production. The Commission's control was an extreme example of one state's attempt to control the industry. M. WILLRICH, supra note 7, at 249-52.
10. For a discussion of federally imposed curtailment and allocation orders in the 1970's, see id. at 77-107.
11. Id. at 245-47.
12. U.S. CONST. art. I, § 8, cl. 3 provides: "The Congress shall have the power . . . to regulate Commerce with foreign Nations, and among the several States . . . ."
14. See M. WILLRICH, supra note 7, at 252; notes 17-73 infra and accompanying text.
15. See notes 76-79 infra and accompanying text.
16. See notes 104-10 infra and accompanying text.
to protect the environment. Several energy producing states realize this objective by taxing the volume of energy produced. Recent tax legislation in New Mexico and Oklahoma illustrates this type of state regulation.

A. The Statutes

The abundance of coal in the northwestern corner of New Mexico,\textsuperscript{17} coupled with the economics of high-voltage transmission of electricity, encouraged the construction of several electrical generating plants in that region.\textsuperscript{18} Utilities and consumers in New Mexico, Arizona, California, and Texas use electricity produced in this area.\textsuperscript{19} New Mexico imposes a tax on any person that generates electricity in New Mexico for the purpose of sale.\textsuperscript{20} The tax applies to each net kilowatt hour\textsuperscript{21} of generated electricity.\textsuperscript{22} New Mexico also provides a credit against its gross-receipts tax for any generation tax paid to New Mexico or to any neighboring state.\textsuperscript{23} The usual gross-receipts tax is roughly equal to four percent of electricity sales.\textsuperscript{24} A person who generates electricity in New Mexico for interstate sale pays a generation tax of about two percent of sales. A person who generates electricity in New Mexico for intrastate sale pays no generation tax, but is liable for a gross-receipts tax roughly equal to four percent of sales. New Mexico's scheme of taxation increases the utilities' cost of operations, which in turn limits development and encourages efficiency. The tax thus deters rapid ex-


\textsuperscript{18} New Mexico, in Arizona Pub. Serv. Co. v. Snead, 441 U.S. 141 (1979), argued that appellant utilities saved $119 million annually by generating electricity in New Mexico and transmitting it, for example, to Phoenix, Tucson, Los Angeles or El Paso. The figure accounts for the economic advantages of generating electricity in this part of the country and the costs associated with coal burning in the densely populated areas to which appellants sell. See generally Bagge, Coal and Clean Air Law: A Case for Reconciliation, 4 Ecology L.Q. 479 (1975); Smith, Electricity and the Environment: A Season of Discontent, 33 Fed. B.J. 71 (1974).


\textsuperscript{21} Electrical Energy Tax Regulation 3:1 (form issued by taxing body of the state of New Mexico to users):

Net kilowatt hours are calculated by subtracting kilowatt hours of electricity used directly in the operation of the plant for a month from the gross kilowatt hours generated by the plant in the same month. Electricity used in any facility of an electrical utility other than a generating plant may not be subtracted from the total of electricity generated to New Mexico.


\textsuperscript{23} Id. § 7-8-80 (1978).

\textsuperscript{24} Id. § 7-9-7 (1978).
exploitation of New Mexico's coal and discourages rapid industrial growth in the four corners region.

Oklahoma taxes the volume of natural gas removed from the ground.25 This complex26 tax scheme affects gas that has a gross value per thousand cubic feet (MCF) between seventeen and one-half cents and one dollar; the tax increases as the value of the gas decreases. Oklahoma provides a credit against the state income tax if all state excise taxes exceed 7.085% of the gross value of minerals produced and if the state has not reimbursed the producer for the excise taxes paid.27

B. Constitutional Issues

1. Commerce Clause

Conservation has traditionally been a function of state power.28 The Constitution, however, might not allow the particular means used to effect this power.29 A tax levied on the generation of electricity produced in New Mexico but sold outside the state burdens interstate commerce. At one time, the mere acknowledgement that the "operating incidence"30 of a state tax affected interstate commerce placed the tax's validity in jeopardy,31 and the states had to show that the taxed activity

26. Id. § 1108(A) provides:
   There is hereby levied on all natural gas and/or casinghead gas produced and saved excluding non-taxable royalty a conservation excise tax of seven cents ($0.07) per thousand cubic feet (MCF), less seven percent (7%) of the gross value of each such MCF of natural gas and for casinghead gas; provided that the conservation excise tax hereby levied shall not exceed one-third (1/3) of the gross value of each such MCF of the natural gas and/or casinghead gas so produced and saved. Provided further, the conservation excise tax herein levied shall never be less than zero.
27. Id. § 2357(D).
28. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 93 (1963) ("There is no doubt that the States do possess power to allocate and conserve scarce natural resources upon and beneath their lands."). See also Patterson v. Standolind Oil & Gas Co., 305 U.S. 376 (1939); Bandini Petroleum Co. v. Superior Court, 284 U.S. 8 (1931); Walls v. Midland Carbon Co., 254 U.S. 300 (1920).
was local in nature. The Court has now expressly eliminated the absolute immunity from state taxation that interstate commerce once enjoyed. A state tax that affects the control of energy in interstate commerce is valid if: 1) there is a substantial nexus between the taxed activity and the taxing state; 2) the tax does not discriminate against interstate commerce; and 3) the tax fairly relates to the services provided by the state. This tripartite rule reflects economic realities and

Pipe Line Co. v. Stone, 337 U.S. 662 (1949); International Harvester Co. v. Evatt, 329 U.S. 416 (1947); Atlantic Lumber Co. v. Comm'r of Corps. & Taxation, 298 U.S. 553 (1936). The Court in Spector flatly invalidated any state tax on the privilege of engaging in interstate commerce. Connecticut had imposed a franchise tax, for the privilege of doing business within the state, on a foreign trucking company using Connecticut highways to conduct its exclusively interstate business. The tax was computed at a nondiscriminatory rate on the part of the company's net income that was reasonably attributable to its business within the state. Thus, it was an invalid tax upon the privilege of engaging in interstate commerce, because the taxpayer had no other business connection with the state. 340 U.S. at 606-10.


A tax is permissible if it applies in proportion to the business carried on within the state, International Shoe v. Shartel, 279 U.S. 429, 433 (1929), but a tax is invalid if it applies to business conducted outside the state. See note 42 infra. Apportionment prevents taxing more of the activity's value than occurs within the state. Wash. Revenue Dep't v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 746-47 (1978); General Motors Corp. v. Washington, 377 U.S. 436, 439-40
is not intended to pose a trap for the unwary state legislature.\textsuperscript{35}

Nexus is the threshold requirement.\textsuperscript{36} A definite link must exist between the taxing state and the person, property, or transaction that the state seeks to tax.\textsuperscript{37} The existence of a nexus is essentially a due process requirement.\textsuperscript{38}

The second element of the test involves the principle that a state may not levy a tax that discriminates against interstate commerce. This rule


In addition, the Court looked for a special relationship between the tax and the aspect of commerce taxed. If the taxing state conferred certain benefits, powers, and privileges on the commerce involved, the Court upheld the tax. Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975); Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948). See 19 B.C. L. REV. 312, 313 (1978). The test of Complete Auto represents the accumulation of over fifty years of judicial thought. See generally Hellerstein, \textit{State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline}, 62 VA. L. REV. 149, 188 (1976). This culmination plus the unanimous nature of the Complete Auto opinion gives great weight to the test.

\textsuperscript{36} \textit{Developments in the Law}, note 32 supra at 968.


is firmly rooted in both history and law. The Court does not limit its inquiry to an evaluation of facial discrimination but accounts for all relevant factors that might make the tax discriminatory when applied. The Court considers the economic nature of the taxed activity, reviews the combinations of taxes that operate against that economic activity, and examines the taxing schemes of neighboring states that affect the commerce involved. Underlying the rule is the desire to


Mechanically stated, the rule is simple: "No state may impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business or by subjecting interstate commerce to the burden of multiple taxation." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959) (citations omitted). A similar test is stated in Dean Milk Co. v. City of Madison, 340 U.S. 349 (1950).


42. Developments in the Law, supra note 32, at 968: "A number of taxes of different descriptions are imposed by different states: franchise taxes, severance taxes, excises on manufacturing, on transportation, storage . . . sales taxes, use taxes. Even if no state exacts payment of all of these, a multistate concern may well find itself paying many . . . ." See also McCullough Trans. Co. v. Division of Motor Vehicles, 113 N.J. Super. 356, 358-59, 273 A.2d 786, 788-89 (App. Div. 1971).

43. The Court recognizes the prohibition against multiple burdens, but it is unclear from the case law whether the prohibition applies to actual burdens or to the mere risk of multiple burdens. Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (potential for multiple burdens considered relevant); Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960) (must show actual discrimination); Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (Court considered conflicting regulations); Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947) (risk of multiple burdens); Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945) (potential for multiple inconsistent burdens). See also Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973); Morgan v. Virginia, 328 U.S. 373 (1946); Hall v. DeCuir, 95 U.S. 485 (1878); Williams Rentals, Inc. v. Tidwell, 516 S.W.2d 614 (Tenn. 1974). Commentators have encouraged the Court to adopt the risk approach, because it prevents one state from exploiting another state's failure to tax interests commerce to the full extent possible. See P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 273-85 (1953); Developments in the Law, supra note 32, at 965. In Complete Auto, however, the
establish a strong union not susceptible to destruction through balkanization of its economy.\textsuperscript{44} Discrimination arises in two contexts: state attempts to erect barriers to outgoing trade and state attempts to erect barriers to incoming trade.\textsuperscript{45}

The third element of the test mandates that a state tax be fairly related to the services provided by the state. The state must provide financial justification for the levy.\textsuperscript{46} States commonly provide a variety of services, including access to the courts and police protection, to persons operating within their boundaries. In addition, states must deal with environmental problems caused by energy production.\textsuperscript{47} Finally, states face socioeconomic problems directly attributable to the growth of communities in which new energy production facilities are located.\textsuperscript{48}

The New Mexico tax may survive a commerce clause test. The subject of the electricity generation tax occurs within the state's boundaries and thus satisfies the nexus requirement.\textsuperscript{49} New Mexico's tax on generation of electricity sold in the interstate market at first appears to be a

\textsuperscript{44} An explication of the Founder's intention appears in Justice Jackson's opinion in H.P. Hood & Sons v. DuMond, 336 U.S. 525 (1949):

"[T]his principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. . . . [T]he established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . ."

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

\textit{Id.} at 537-39.


\textsuperscript{47} Ingels v. Morf, 300 U.S. 290 (1937); Interstate Transit, Inc. v. Lindsey, 283 U.S. 183 (1931); Clark v. Poor, 274 U.S. 554 (1927). The Court diluted this requirement by creating a strong presumption that the tax represents no more than reasonable compensation to the state.


discriminatory burden on outgoing trade, because interstate sellers must pay the two percent generation tax, while intrastate sellers are allowed to credit the generation tax against their gross-receipts tax. Intrastate sellers, however, remain liable for a gross-receipts tax that is close to four percent, which is a greater tax burden than that imposed on interstate sellers.\(^{50}\) For these reasons, energy production taxes structured like New Mexico’s do not discriminate against interstate commerce. Concerning the relationship between services and the tax, New Mexico must show that the state uses the revenue received from the tax to alleviate the problems caused by energy production and to provide required services.\(^{51}\) The Court has vigorously expressed its intentions to require more than legislative design as a justification.\(^{52}\) In order to make a prima facie case, the state should provide figures that accurately show total direct costs, total indirect costs, and the attributable share of each to the taxpayer operating in interstate commerce.\(^{53}\) A state could determine whether a fair relationship exists between the tax and the services provided by matching these figures with the estimated proceeds. States have not made this type of showing in the courts,\(^{54}\) which suggests that an inequitable relationship exists between the taxes paid by energy producers and the costs incurred by the state. Although this analysis indicates a need for stricter scrutiny, the Court will not necessarily invalidate a tax like New Mexico’s if a reasonable basis exists for taxing producers.

The foregoing analysis sustains the New Mexico generation tax against a commerce clause challenge. The Oklahoma tax should also survive commerce clause criticism. The commerce clause test requires

\(^{50}\) See notes 23-24 supra and accompanying text.


\(^{52}\) Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429 (1978) (Court invalidated a safety regulation as an impermissible burden on interstate commerce; state failed to demonstrate sufficiently that the regulation actually enhanced safety).

\(^{53}\) The Supreme Court has not required a detailed showing. Instead, a state is permitted to impose a tax to pay for provisions to the taxpayer of police protection, for access to legal process, for access to the courts, and for the right to sell property, without a specific showing of costs attributable to the group of taxpayers levied against. Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 109 (1975); Memphis Natural Gas Co. v. Stone, 335 U.S. 80, 96 (1948).

a nexus between the activity and the state, nondiscrimination against interstate commerce, and a reasonable relationship between the tax and state services. Gas production is the direct result of an activity that occurs within the state’s boundaries. The numerous gas wells in the state are physical evidence of the nexus between the activity taxed and the taxing state. The Oklahoma tax satisfies the second part of the commerce clause test, because it does not discriminate against interstate commerce. Oklahoma taxes all in-state production at a facially nondiscriminatory rate. The state allows the taxpayer a credit for a portion of the taxes paid, but applies the credit against a tax on all producers—the state income tax. Interstate producers may use the credit to the same extent as intrastate producers. In this way, Oklahoma avoids unconstitutional discrimination against interstate commerce.\footnote{55} The Oklahoma tax may be fairly related to the state services provided to producers, but Oklahoma has not offered empirical proof to substantiate the relationship. The tax yielded forty million dollars in 1978.\footnote{56} The state has not disclosed the types of services and the cost of providing the services.\footnote{57} If challenged, Oklahoma would be forced to demonstrate a fair relationship. Although an application of strict scrutiny is unlikely, a court would demand more than a general recital of costs.

2. **Supremacy Clause**

The New Mexico and Oklahoma statutes must also undergo supremacy clause analysis.\footnote{58} Congress recently enacted legislation

55. The tax indirectly favors intrastate sales, because it decreases with increases in gross value. Higher gross values attach to intrastate sales. Intrastate sellers, therefore, pay less tax than interstate sellers, because of federally imposed lower prices on interstate gas. Any discrimination that results is too tenuously related to the state tax to raise constitutional concerns. See notes 25-27 *supra* and accompanying text.

56. See notes 25-27 *supra* and accompanying text.

57. See notes 104-10 *infra* and accompanying text.


Congress may exercise an enumerated power to achieve an end within the scope of the enumerated power themselves. . . . When Congress regulates an activity . . . within the scope of an enumerated power, as a means to some end that is also within the enumerated powers, the power of the states to regulate either the means or the ends depends upon the will of Congress.


Before congressional action, the Court is concerned with the preemptive power of the dormant

https://openscholarship.wustl.edu/law_lawreview/vol58/iss2/5
prohibiting electricity generation or transmission taxes that discriminate against out-of-state consumers.\(^{59}\) In *Arizona Public Service Co. v. Snead*,\(^{60}\) the Court relied on federal legislation to invalidate the New Mexico generation tax,\(^{61}\) basing its decision on the supremacy clause.\(^{62}\) The New Mexico tax, through the operation of its tax credit provisions, imposed a levy against interstate market electricity and exempted electricity bound for intrastate markets. Congress was not concerned with the impact of the entire scheme of taxation. Congress intended the statute to invalidate a discriminatory tax on generation.\(^{63}\) In view of this narrow meaning of discrimination, the New Mexico generation tax indirectly, but necessarily, discriminated against interstate commerce. The supremacy clause invalidated the tax because the tax conflicted directly with federal law.\(^{64}\) This federal legislation does not necessarily preclude all generation taxes; there is evidence that Congress specifically designed the federal law to invalidate the New Mexico tax.\(^{65}\)


60. 441 U.S. 141 (1979).
61. *Id.* at 148-49.
62. *Id.* at 146.
63. *See* note 65 infra and accompanying text.
64. 441 U.S. at 149-50.

When confused, courts may consult the legislative history as an aid to construction—Train v. Colorado Pub. Interest Research Group, 426 U.S. 1, 10 (1975); United States v. American Truck-

Washington University Open Scholarship
The Natural Gas Act of 1938\(^6\) prevents the states from directly or indirectly regulating the price of gas sold in interstate commerce.\(^67\) The Oklahoma tax on production is a cost ultimately borne by the consumer and thus, constitutes an indirect regulation of rates. In addition, the Natural Gas Act and its regulations show a clear congressional intent to subject natural gas to uniform rates and regulations.\(^68\) Supplementary state regulation is inappropriate,\(^69\) especially if that regulation hinders the objective of uniformity by imposing a tax that discriminates against interstate commerce. State production taxes, however, fall outside the scope of the Act.\(^70\) The Federal Energy Regulatory Commission (FERC) is without power to expand the scope of the Act.\(^71\) For these reasons, a tax on production avoids preemption. If the tax does not contravene the commerce clause, it provides the states with a valid means of protecting their energy resources. Taxes on generation are valid if not complicated by crediting schemes that nullify the liability of intrastate generators.\(^72\) In addition, a taxing scheme is valid if it lowers the gross-receipts tax on sales of electricity instead of providing for a gross-receipts tax credit equal to the generation tax. This type of taxing scheme is appropriate even though the plan has the same practical effect as the New Mexico tax because it embodies an even-handed tax on generation.\(^73\)

Another way in which the states can avoid preemption problems is to tax activities that Congress entrusted to state regulation. The genera-


\^70^ Statements of General Policy and Interpretation under the Natural Gas Act, 18 C.F.R. § 2.56(a) (1979), exclude from the rate base all state or federal taxes on production. Federal Power Comm'n v. Panhandle E. Pipe Line Co., 337 U.S. 498, 503 (1949) (Act expressly exempts from its coverage the production and gathering of natural gas).

\^71^ Mobile Oil Corp. v. Federal Power Comm'n, 463 F.2d 256 (D.C. Cir. 1972).


\^73^ Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 278 n.7 (1977).
tion tax, which imposed economic disincentives on coal mining, prompted conservation. New Mexico could have imposed similar disincentives by increasing the tax on the severance of coal from the ground. The tax would slow depletion of a finite energy resource and would discourage exploitation of New Mexico’s coal fields by increasing the cost of electricity generated from this coal. The Oklahoma tax utilizes this technique.

II. COMPENSATION FOR EXTRACTION OF ENERGY RESOURCES

A. Economic Background

The second objective of energy producing states, compensation for the depletion of wealth associated with the extraction of energy resources, suggests a desire by these states to provide for themselves at the expense of the nation. The framers of the Constitution designed the commerce clause to prevent this type of balkanization. The Supreme Court expressed at an early date, in Pennsylvania v. West Virginia, its intolerance for state regulation that favored state citizens to the detriment of foreign citizens. In 1920, natural gas reserves in West Virginia were significantly depleted. Noting the increasing demand for gas, the state legislature required each distributor of gas produced in West Virginia to meet the in-state demand before distributing gas interstate. The legislature, through regulation, afforded in-state consumers a preferred right of purchase of West Virginia gas. The Court invalidated this regulation that clearly discriminated against interstate consumers of energy.

A tax which compensates a state for the depletion of its valuable energy resources is similarly invalid because the tax requires foreign citizens to reimburse the state for the loss of resources and simultaneously benefits the state’s citizens from the lower price of the product. The pursuit of compensation for extraction of resources necessarily ex-

74. See note 39 supra.
75. 262 U.S. 553 (1923).
76. Id. at 593. For a similar result, see West v. Kansas Natural Gas Co., 221 U.S. 229 (1920): The statute [of Oklahoma] recognizes [gas] to be a subject of intrastate commerce, but seeks to prohibit it from being the subject of interstate commerce, and this is the purpose of its conservation. . . . If the States have such power a singular situation might result. Pennsylvania might keep its coal, the Northwest its timber, the mining States their minerals. . . . If one State has it, all States have it; embargo may be retaliated by embargo, and commerce will be halted at state lines.

Id. at 255.
exploits foreign citizens in need of energy, inhibits free competition, and prevents free trade among the states.\textsuperscript{77} A state desiring this kind of compensation should not declare that intention\textsuperscript{78} because the declaration taints the court’s analysis and provides a basis for invalidating the tax. Louisiana recently enacted a use tax on energy.\textsuperscript{79} The tax does not specifically propose to derive compensation for the depletion of energy resources, but the history behind its enactment suggests that the legislature intended compensation.\textsuperscript{80}

Prior to 1950, Louisiana maintained sovereignty over the tidelands off its coast, which held an abundant supply of oil and gas. A series of Supreme Court cases deprived Louisiana of this valuable offshore

\textsuperscript{77} The Court has not permitted the states to burden the exportation of local products to enhance local interests. Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (invalidated Arizona law requiring canteloupes to be packaged in-state); H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949) (denial of license to Massachusetts milk distributor by state of New York on ground that local supply would be reduced overturned); Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1 (1928) (restrictions on interstate shipment of shrimp as means of insuring local employment invalidated); cf. Sligh v. Kirkwood, 237 U.S. 52 (1915) (upholding state law prohibiting the interstate shipment of citrus fruit not fit for consumption).

The Court has permitted state regulations that prohibit the shipment of water out of the state, Hudson County Water Co. v. McCarter, 209 U.S. 349, 356 (1908), and wild animals, Geer v. Connecticut, 161 U.S. 519, 529 (1896); McCready v. Virginia, 94 U.S. 391, 394 (1877). The Court has not overruled these decisions, but they are dubious and deserve mention only because of the interesting theory advanced in the cases. The Court recognized the state as an equitable owner of all state resources on behalf of the citizenry until these resources were reduced to possession. In this capacity, the state could regulate certain transactions before they become a part of interstate commerce.

The recognized invalidity of state action advantaging local citizens at the expense of interstate citizens is a principle the Court applies in privilege and immunity clause cases. See Baldwin v. Fish and Game Comm’n, 436 U.S. 371 (1978); Toomer v. Witsell, 334 U.S. 385 (1948).

\textsuperscript{78} The taxing states demonstrated a desire to raise revenue, perhaps partly to account for the indirect costs associated with energy production. More pertinent to this discussion, each state enacted a tax to equalize what it perceived to be inherent discrimination operating against the state and its citizens. This assertion, though speculative, follows from the history surrounding the taxes. Louisiana probably considers the gas producers on the Outer Continental Shelf, who were once under Louisiana’s control, unfairly advantaged because they need not pay a tax comparable to the Louisiana severance tax. See note 83 infra. Oklahoma also reacted, eliminating an existing discrimination perceived to operate against its citizens because of the effect of federal regulations on severance taxpayers. See note 55 supra. New Mexico implies a similar dissatisfaction with pretax conditions, perhaps feeling exploited by neighboring states and their citizens. See note 18 supra.

\textsuperscript{79} LA. REV. STAT. ANN. § 47-1301-07 (West Supp. 1980). See notes 83-88 infra and accompanying text.

\textsuperscript{80} See note 8 supra. See also First Use Tax, 31 La. Coastal L. Rep. 1 (October 1978).
property. In 1976 Congress passed legislation returning some of the property, but Louisiana still lacks sovereignty over most offshore gas production. Louisiana thus, cannot tax offshore producers under the state severance tax on natural gas. Louisiana’s inability to tax awards offshore producers an economic advantage over Louisiana producers, who must pay a severance tax.

Louisiana imposed a tax on the first use of gas in the state to eradicate this economic discrepancy. “First use” includes any ascertainable action within the state. First uses include sale, transportation to a point of delivery, and processing for the extraction of waste. A tax of seven cents per MCF applies to the first use of gas. The first use tax exempts gas already subject to a severance tax on the volume of production. The scheme excludes all gas purchased in Louisiana and in neighboring states. The tax, in practical terms, operates only against gas entering the state from the Outer Continental Shelf or from foreign countries. In addition, the state provides a credit against the use tax equal to any severance tax due Louisiana. Only producers who own wells on the Shelf and in Louisiana may credit any use tax against severance tax liability because only these producers are liable for both the Louisiana severance tax and the Louisiana use tax. This circumstance further focuses the impact of the use tax on non-Louisiana producers.

85. Id. § 47-1302(8): “Use” is: the sale; the transportation in the state to the point of delivery at the inlet of any processing plant; the transportation in the state of unprocessed natural gas to the point of delivery at the inlet of any measurement or storage facility; transfer of possession or relinquishment of control at a delivery point in the state; processing for the extraction of liquefiable component products or waste materials; use in manufacturing; treatment; or other ascertainable action at a point within the state.
86. Id. § 47-1303(B).
87. Id. § 47-1303(A).
B. Constitutional Analysis
   
   1. Commerce Clause
      
      a) Nexus
      
      The commerce clause analysis begins with the nexus requirement. The nexus between the "first use" and Louisiana is not readily apparent. The subject of the tax is not the gas, the property, or the right to produce the gas—rather, the tax applies to the first use of gas in the state, whether the use is sale, transportation, transfer of possession, or processing.\(^91\) The presence of several salesmen conducting local solicitation is sufficient to charge an out-of-state seller with a use tax on the sale of goods shipped to customers in-state;\(^92\) but when the taxpayer is engaged only in the delivery of goods to a point in-state, the nexus is insufficient.\(^93\) The use tax on transportation of gas inland, therefore, is suspect. Transportation of gas, however, differs from the delivery of other goods. Gas travels by pipeline or ship; the pipeline owns most of the gas brought ashore.\(^94\) The state gives the pipelines, which necessarily touch Louisiana, police and judicial protection. In return, the state taxes the operation of the pipelines. Similarly, shipping lines that deliver gas use state police and judicial protection while docked in Louisiana ports. This nexus satisfies the constitutional requirement.
      
      b) Discrimination
      
      The tax may not discriminate against interstate commerce. This requirement is the major obstacle to achieving compensation for extraction of resources. Compensating use taxes are valid despite challenges based on discrimination.\(^95\) The Louisiana use tax eliminates some of


the economic advantages once enjoyed by interstate concerns. Offshore producers, not liable for a severance tax, now pay a use tax. Louisiana producers, not liable for a use tax, now pay a severance tax. The Louisiana tax, because it equalizes the treatment of intrastate and interstate producers, is valid. Opponents, however, contend that the tax is designed to provide a source of compensation for the depletion of offshore reserves originally under Louisiana sovereignty. The tax would thus, discriminate against interstate commerce because it would burden incoming gas rather than gas produced in-state. A reviewing court might hold the tax invalid if the court would conclude that the Louisiana measure is actually a production tax on offshore gas.

c) Relation Between the Tax and State Services

The Louisiana tax does not violate the third prong of the commerce clause test. Louisiana incurs costs in providing state services to pipeline and tanker owners. Information detailing the actual revenue needed to provide state services is not available. Louisiana should be able to demonstrate a reasonable relationship between revenues and costs and justify at least part of the intake.

2. Supremacy Clause

The Louisiana tax faces other constitutional challenges; a possible

were subject to a tax equal to the Washington sales tax. In-state sales were exempt, because the compensating tax was designed to equalize the treatment of all users of retail merchandise in Washington.

96. See note 4 supra. Production taxes compensate the state for depletion of the resource to the extent that the revenue received exceeds the cost of production to the state, e.g., environmental damage. The same logic applies to the Louisiana use tax levied against offshore producers.


Based on the OCS volumes entering Louisiana in interstate commerce in 1977, the imposition of the First Use Tax will cost interstate consumers approximately $225,000,000 per annum. By geographic region, the impact of the First Use Tax will be as follows: New England $6.8 million, Appalachian $84.8 million, Southeast $28.6 million, Great Lakes $52.4 million, Gulf Coast $48.5 million.

98. The Louisiana tax exempts the use of gas in the manufacture of fertilizer or ammonia within the state. La. Rev. Stat. Ann. § 47-1303(A) (West Supp. 1980). This provision is open to
violation of the supremacy clause is the most formidable.\textsuperscript{99} FERC has the express power to establish a uniform regulation of the sale and transportation of gas traveling in interstate commerce.\textsuperscript{100} FERC's authority is inclusive of the power to fix prices.\textsuperscript{101} Unlike the severance tax, the use tax is not outside the scope of FERC's control. A conflict thus, arises between the exercise of federal power and state taxation.\textsuperscript{102} FERC's opposition to the tax\textsuperscript{103} may perhaps preempt the state tax.

The above discussion indicates that achieving the first objective of compensation for extraction of resources is very difficult, if not impossi-
ble. A state may not devise a taxing scheme that exploits interstate consumers by exacting from them compensation for the depletion of the states' resources. The courts are likely to disfavor this second objective of energy producing states because of the need for the unimpeded flow of interstate commerce. The third enumerated objective—compensation for environmental change—is not difficult to realize.

III. COMPENSATION FOR ENVIRONMENTAL DAMAGE AND ANCILLARY COSTS OF PRODUCTION

The energy producing states seek compensation for environmental damage and other related costs of energy production. Taxation is the most logical means to reach this objective. The commerce clause, according to recent interpretation, does not prohibit a tax that provides this compensation, but rather encourages a tax imposed to compensate for environmental damage. The Court recognizes that interstate commerce is not immune from state taxation if the tax is fairly related to services provided.

The taxes described above respond, at least in part, to the cost of reversing the environmental damage associated with energy production. The states allocate most of the proceeds derived from the taxes to general revenue accounts, but also devote a substantial amount to


106. See notes 33-38, 49 supra and accompanying text.

conservation. 108

Energy production certainly causes environmental damage—the issue is the extent of the damage. Under present commerce clause analysis, costs must fairly relate to revenue. 109 The state bears the burden of showing an acceptable correlation between revenues and costs because the state has ready access to the necessary figures. 110 A reasonable relation, not necessarily a one-to-one correlation, must exist.

CONCLUSION

Energy producing states desire control over the amount and manner of production, compensation for the depletion of their energy resources, and compensation for damage to the environment and for socioeconomic problems associated with energy production. These states often attempt to achieve these goals through taxation.

This Note has attempted to demonstrate the various problems raised by the imposition of a state tax on energy. Approaches to the problems begin with a thorough examination of the taxation statute’s design. The constitutional analysis consists of a series of questions: is there a sufficient nexus with the taxing state?; does the tax discriminate against interstate commerce?; is the tax fairly related to the services provided by the state?; has Congress preempted state regulation in this area? This line of questioning can demonstrate the validity of a state tax on energy.


108. Louisiana, for example, allocates 25% of the proceeds to a special conservation fund. In 1979, Louisiana expected the tax to yield $185,000,000. Thus, the state allocated $406,625 for the restoration of Louisiana’s coastlines and barrier reefs. First Use Tax, 31 La. Coastal L. Rep. 1 (October, 1978).

109. See notes 33-38, 49 supra and accompanying text.

110. The best analogy is to federal income tax law. The taxpayer carries the burden of proving his deductions. Hughes v. Commissioner, 451 F.2d 975 (2d Cir. 1971); cf. Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930) (Board of Tax Appeals allowed to use estimates for expenses in computing tax owed). See Heckerling, The Rise and Demise of the Cohan Rule, 7 TAX COUNSELOR’S Q. 23 (1963); Sheehan & Sullivan, Convention Expenses: How to Prove Business Connection to the IRS’s Satisfaction, 6 TAX. FOR ACCOUNTANTS 146 (1971); Taylor, Record Keeping Requirements: Steps to Take to Avoid Disallowance of T & E Expenses, 5 TAX. ACCOUNTANTS 366 (1970).

https://openscholarship.wustl.edu/law_lawreview/vol58/iss2/5
distribution of natural resources may be preempted. Preservation of the environment through compensatory assessments, however, is not beyond the limits of state power. In addition, state taxes are valid if they are designed to raise a fair sum for the cost of providing state services incident to energy production. Any tax is unconstitutional if the tax recoups the depletion of a state's wealth and is not in some measurable way associated with actual costs to the state. Constitutional demands force the producing states to recognize their inability to favor their own citizens or to hoard future supplies. These same demands, however, allow the prevention of resource exploitation, which benefits the individual states and the nation.

James L. Case