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SUPREME COURT OPENS DOOR TO MORE STATE REVENUES FROM MINED RESOURCES

MINING LAW—SEVERANCE TAXES: The United States Supreme Court upheld Montana's 30% coal severance tax because it violates neither the commerce clause nor the supremacy clause of the United States Constitution. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981).

INTRODUCTION

Regardless of conservation measures taken by the public as a result of energy prices and shortages, total energy demand is projected to continue increasing over the next two decades.¹ Of the common energy resources, nuclear fuel and coal demand will increase the most.² Consequently, production of fuel and nonfuel mineral resources has been stepped up to meet the demand.³ The United States Supreme Court in its recent decision in *Commonwealth Edison Co. v. Montana*⁴ (hereinafter *Commonwealth Edison*) has left the door open for the states to exploit this accelerated rate of resource extraction.⁵ Arguably, the only ceiling left on the tax rate imposed on minerals is what legislatures and Congress wish to impose.

Traditionally, states have levied ad valorem or production taxes to generate revenues from mined resources.⁶ Ad valorem taxes tax ownership of mining property. Although various methods of valuation of mine property have evolved, such as basing mine value on market value of the mine or on mine output, valuation of mine property remains an inherent difficulty in implementing these taxes.⁷ Because of these valuation problems and the resultant unreliability of revenue production, ad valorem taxes have increasingly been replaced by production taxes.⁸

Production taxes are based on the act or privilege of severing minerals,

1. U.S. DEPT. OF INTERIOR, THE ENERGY FACTBOOK 81 (1980). The annual demand growth rates per year of primary energy demand as projected are: 1.3% 1979-1985, 1.5% 1985-1990. Overall growth rate between 1979 and 1990 is 1.4%.

2. *Id.* Between 1979 and 1990 annual nuclear fuel demand is predicted to increase 10.9% and coal demand is predicted to increase 4.0%.

3. For example, uranium production increased from 18,490 tons in 1978 to 18,730 tons in 1979. *Id.* at 705. New Mexico led in U₃O₈ production at 7,420 tons in 1979. *Id.* Wyoming, Utah, and New Mexico in that order hold the largest land areas for uranium exploration and mining. *Id.* at 713. New Mexico and Wyoming far outweigh other states in estimated and undiscovered uranium. *Id.* at 717.

4. 453 U.S. 609 (1981).

5. Even without increases in amount of tax, state revenues from taxes could increase because the value of mineral resources mined rose from \$20 billion in 1978 to \$24 billion in 1979. Cooper, *Mining and Quarrying Trends in the Metal and Nonmetal Industries*, U.S. DEPT. OF INTERIOR, 1 MINERALS YEARBOOK 1 (1981).

6. A good source of information, although somewhat dated, is Tippitt, Oldham, Brightwell, *Ad valorem and Production Taxation of Mining Properties*, 4 AM. L. MINING 701 (1963).

7. *Id.* at 702.

8. *Id.* at 702, 704.

the business of mining, or the value of production.⁹ Tax formulas for production taxes may be based on net proceeds, gross proceeds, quantity severed, or merely the privilege of doing business.¹⁰

The courts' involvement in the taxing process has changed over the years. At one time, the courts totally prevented states from taxing minerals destined for other states because the privilege of doing interstate commerce was not subject to state taxation.¹¹ However, the "local incidents" exception to the no tax rule soon developed.¹²

In *Heisler v. Thomas Colliery Co.*,¹³ one of the best known cases which applied the exception, the Supreme Court held a Pennsylvania coal tax constitutional because it was levied on the coal prior to commencement of its movement from the state. The Court rejected the notion that products of a state could be in interstate commerce prior to being moved from the place of their production or preparation.¹⁴ To hold otherwise, the Court continued, would subject to commerce clause scrutiny the "fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet 'on the hoof,' wool yet unshorn, and coal yet unmined."¹⁵ Later, it became a word game, the constitutionality of a law riding on whether the tax could fit into the "local incidents" exception.

For example, the Court in *Spector Motor Service v. O'Connor*¹⁶ held unconstitutional a Connecticut tax levied on foreign corporations headquartered in the state for the privilege of doing business in the state. It was irrelevant that the tax would have been constitutional had it been called compensation for the corporations' use of the highways. Thus, constitutionality could depend on what name a legislature gave a tax.¹⁷

A break from the formalism of these cases came when *Complete Auto Transit v. Brady*¹⁸ (hereinafter *Complete Auto*) overturned *Spector Motor Service*¹⁹ and its progeny. The Court reasoned that the existing law by its formalism avoided the issues of the commerce clause. *Complete Auto* upheld a Mississippi gross receipts tax on the privilege of doing business in the state, and, in doing so, set forth new criteria for testing commerce

9. *Id.* at 702.

10. *Id.* at 729. License and occupation taxes are also examples of privilege taxes. Alaska, Arizona, Colorado, Idaho, Montana and New Mexico are some western states which have enacted production or license taxes.

11. See *Memphis Steam Laundry Cleaner, Inc. v. Stone*, 342 U.S. 389 (1952).

12. *Coe v. Errol*, 116 U.S. 517 (1886).

13. 260 U.S. 245 (1922).

14. *Id.* at 259.

15. *Id.* at 259-60.

16. 340 U.S. 602 (1951).

17. Browde, DuMars, *State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier*, 60 OR. L. REV. 7, 20 n. 62 (1981).

18. 430 U.S. 274 (1977).

19. *Id.* at 288.

clause challenges. A tax will survive commerce clause scrutiny when there is (1) substantial nexus with the taxing state, (2) fair apportionment, (3) no discrimination against interstate commerce, and (4) fair relation to the services provided by the state. *Commonwealth Edison* is one of the latest cases to apply the test.

COMMONWEALTH EDISON

The Clean Air Act of 1970 created a demand for low sulfur Montana coal.²⁰ The Montana legislature in 1975 enacted a tax schedule which placed most of the coal mined in the state into the maximum severance tax bracket of 30%.²¹

The tax enraged both coal producers and out-of-state consumers. In June 1978, four Montana coal producers and 11 of their out-of-state utility customers (appellants) filed suit in Montana state court requesting (1) refund of over \$5.4 million in severance taxes paid under protest, (2) invalidation of the tax under the commerce and supremacy clauses of the United States Constitution, and (3) an injunction against further collection of the tax.²² The trial court granted defendants' motion to dismiss for failure to state claims upon which relief could be granted.²³

On appeal, the Montana Supreme Court upheld the tax.²⁴ The commerce clause issue was decided alternatively. First, the court relied on the "local incidents" theory. That is, since severing of minerals is an intrastate activity, a tax on severing minerals is also an intrastate activity. Therefore, the statute is not subject to commerce clause scrutiny. The alternate ground upon which the Montana court relied was that the tax satisfied the *Complete Auto* test. The court decided that the supremacy clause was not at issue because no federal-Montana statutory conflict existed.

In taking the case under consideration, the United States Supreme Court determined that commerce clause restrictions apply to state severance taxes for two reasons.²⁵ First, no real distinction exists between severance taxes and other types of state taxes subject to commerce clause scrutiny

20. Generally, western coal is lower in sulphur than eastern coal. Telephone interview with James Madison, Administrator, Miscellaneous Tax Division—Mont. Dep't of Revenue (Apr. 6, 1982). Brief Amicus Curiae of the State of Kansas in Support of Appellants' Jurisdictional Statement at 3, 453 U.S. 609 (1981), stated that Wyoming and Montana together have 68% of the nation's low sulphur coal.

21. MONT. CODE ANN. § 15-35-103 (1979). The 30% figure was quoted from Appellants, Statement of the Case at 4, 453 U.S. 609 (1981), and confirmed in the telephone interview with James Madison, *supra* note 20. One possible reason for the tax schedule change was that members of the Montana legislature believed that with the increased demand for coal and resultant increased value, the tax system of dollars per weight of mineral was outmoded. *Supra* note 19.

22. 453 U.S. 609, 613 (1981).

23. *Commonwealth Edison Co. v. Montana*, ___ Mont. ___, 615 P.2d 847, 849 (1980).

24. 615 P.2d 847 (1980).

25. 453 U.S. 609, 616 (1981).

which substantially affect interstate commerce although levied prior to entry of the goods into the stream of commerce.²⁶ Second, commerce clause scrutiny will not necessarily undermine the states' taxing authority because a tax on interstate commerce is not per se invalid. The states have a significant interest in exacting from interstate commerce a fair share of the cost of state government.²⁷

The parties to the action conceded that a substantial nexus with the taxing state and fair apportionment existed. The Court then applied the last two prongs of the four-prong *Complete Auto* test.

In addressing the third prong of the test, the appellants argued that discrimination existed because out-of-state consumers primarily bore the tax burden. The Court dismissed this argument because the third element concerns whether different groups are taxed equally on equal amounts of minerals,²⁸ not whether a particular group eventually pays more because it consumes more. The tax satisfied the third prong because both in-state and out-of-state consumers paid the same rate of tax.

Similarly, appellants' fourth prong argument was against the tax rate and subsequent dollar amount realized by the state. The Supreme Court reasoned that general support and upkeep of a civilized government, which includes providing police and fire protection, a trained work force, and other advantages of a civilized society, are valid reasons for a tax. Additionally, the tax compensates a state for depletion of its resources and inherent wealth. Due process does not require that taxes collected from a particular activity be reasonably related to the value of state services provided to that activity.²⁹

The Court concluded that when a tax is a percentage of the value of coal severed, it is in proper proportion to the taxpayer's activities within that state.³⁰ The percentage rate of a tax is a political question more appropriately resolved in the political arena. Courts should not be involved with the type of fact finding required to balance competing interests in order to arrive at an acceptable tax rate.

Although the holding on the fourth prong issue was not contrary to previous applications of the test in *Complete Auto*, *Department of Revenue of Washington v. Association of Stevedoring Companies*,³¹ and *Japan Line, Ltd. v. County of Los Angeles*,³² it made definitive that which was only

26. *Id.*

27. *Id.*

28. *Id.* at 618.

29. *Id.* at 622. The Court there stated that any other view would involve abandonment of the principle that taxes and the government which they support are for the common good.

30. *Id.* at 624.

31. 435 U.S. 734 (1978). However, the tax in this case was only 1%.

32. 441 U.S. 434 (1979). However, the case found the law in question unconstitutional on grounds that do not apply in *Commonwealth Edison*.

alluded to previously. That is, as long as a tax is levied as a fixed percentage, it is unlikely that the tax will be deemed to exceed the benefits provided by the state or to unfairly burden interstate commerce. Justice Blackmun, in his dissent, stated that the Court's decision opened up the tax to any rate which legislatures wished to impose.³³

On the supremacy clause issue, appellants argued that the tax was invalid because it substantially frustrated the purposes of the Mineral Lands Leasing Act of 1920 by reducing the amount of royalty payments to the federal government.³⁴ The Court, however, found the tax consistent with the supremacy clause. The Montana tax does not frustrate the Mineral Lands Leasing Act³⁵ merely by resulting in reduction of royalty payments to the federal government.³⁶ No language in the Act indicated that Congress intended to maximize and capture all economic rents from federally leased mineral lands. The Court also rejected appellants' contention that the tax frustrates the national energy policies of encouraging greater use of coal and reduction in demand for petroleum products.³⁷ The Court reasoned that Congress did not intend to preempt all state legislation which might adversely impact on coal use.

CONCLUSION

This case provides energy rich states a greater edge in the struggle between the states with energy resources and the consumers in states without energy resources. The appellants in their Jurisdiction Statement argued that the "OPEC like Revenue Maximization" of Montana would lead to Balkanization between resource-rich and resource-poor states with subsequent efforts at retaliation.³⁸ It is certainly a volatile issue.³⁹

The states using resources upon which severance taxes have been levied worry about the effects of energy prices on industrial growth and private

33. 453 U.S. 609, 645 (1981). Justice Blackmun in his dissent also points out that the question presented was not whether appellants would succeed on the merits, but whether the appellants' case should be dismissed for failure to state a claim. However, it appears that the Court by deciding the case on the merits, or on the briefs and pleadings since the case was dismissed below, was saving the trouble of having to hear it again later.

34. *Id.* at 629.

35. Mineral Lands Leasing Act of 1920, 30 U.S.C. § 181 et seq. (1920 Act). The Court referred to § 32 of the Act as providing for state imposition of severance taxes on federal leases. The federal preemption issue was probably important enough to bring up at the trial because $\frac{3}{4}$ of the coal in Montana belongs to the federal government. Appellants, Statement of the Case, *supra* note 20.

36. This view was affirmed in *Merrion v. Jicarilla Apache Tribe*, ___ U.S. ___, 102 S.Ct. ___ (1982).

37. *See* Energy Policy and Conservation Act, 42 U.S.C. § 6201 (1976).

38. Appellants, Jurisdiction Statement, 49 U.S.L.W. 4957 and 453 U.S. 609, 643 (1981).

39. This is evidenced by the number of amicus curiae briefs filed when the case eventually reached the Supreme Court. Among those who filed on behalf of the plaintiffs-appellants were: Tex., Kan., N.J., Minn., Iowa, Mich., Wis., Crow Tribe of Indians, members of Congress from 10 states. 453 U.S. 609, 611 (1981).

consumers in those states.⁴⁰ On the other hand, western states, whose primary revenue raising and wealth sustaining assets are their resources, need to provide for the future when the resources are depleted or no longer demanded.

Arguably, a contrary decision in this case would have invited a flood of commerce clause claims. Nevertheless, it is apparent that the states should feel free to enact statutes similar to that of Montana or to raise existing statutory tax rates. The political process is the only check remaining on these rates. With the present membership in the United States Supreme Court, and the projected conservative membership in the near future, it is unlikely that the Court will reverse the present trend of giving states more leeway to steer their own courses. However, a cautionary note, unchecked rates could force Congress to put a ceiling on the tax levels through direct ceiling legislation or some type of preemptive legislation in a backlash against the less densely populated resource rich western states.⁴¹

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40. See Brief Amicus Curiae of the State of Texas in Support of Jurisdictional Statement. 453 U.S. 609, 611 (1981).

41. This possibility was pointed out in the concurring opinion by Justice White. 453 U.S. 609, 638 (1981).