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Constitutional Law - Commerce Clause Standards for State Taxation of Mineral Severance: Commonwealth Edison, et al. v. State of Montana, et al.

Christine A. Chute

CONSTITUTIONAL LAW—Commerce Clause Standards for State Taxation of Mineral Severance: Commonwealth Edison, et al. v. State of Montana, et al., _____ U.S. _____, 101 S.Ct. 2946 (1981).

The State of Montana taxes the severance of coal up to a maximum of approximately 30% of the contract sales price,[1] depending on BTU content. Most of the coal mined in Montana—an estimated 90%—is shipped out of state, usually under long-term contracts which provide that the cost of taxes will be passed along to the utilities who buy the coal. The utilities, in turn, generally pass the increased price along to their electricity customers.[2]

Four Montana coal producers and eleven of their out-of-state utility customers filed suit against the state in Montana district court claiming that the severance tax is invalid under the Commerce[3] and Supremacy Clauses[4] and seeking a refund of severance taxes already paid and an injunction against continued collection of the tax. The district court, without taking evidence in support of either side, granted the state's motion to dismiss for failure to state claims upon which relief could be granted. The Montana Supreme Court upheld the trial court's dismissal.[5]

On direct appeal to the Supreme Court of the United States, the Appellants proposed to show at trial[6] that the 30% severance tax constitutes a prohibited burden on interstate commerce; that the tax substantially frustrates national energy policies in violation of the Supremacy Clause; and that the tax disturbs the allocation of tax revenues mandated by the Mineral Lands Leasing Act of 1920,[7] as amended by the Federal Coal Leasing Amendments Act of 1975.[8]

The Supreme Court upheld the tax in its current amount, holding that an evenhanded tax on the severance of minerals

1. MONT. REV. CODES ANN. § 15-34-101 (1979). "Contract sales price" is defined as the price of the coal extracted and prepared for shipment f.o.b. the mine, less the amount charged by the seller to pay taxes on production. MONT. REV. CODES ANN. § 15-35-102(1) (1979).
2. Brief of Appellants at 8, Commonwealth Edison v. Montana, _____ U.S. _____, 101 S. Ct. 2946 (1981).
3. "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . ." U.S. CONST. art. I, § 8, cl. 3.
4. The "Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land . . ." U.S. CONST. art. VI, cl. 2.
5. Commonwealth Edison Co. v. Montana, _____ Mont. _____, 615 P.2d 847 (1980).
6. Brief of Appellants, *supra* note 2, at 14-16.
7. 30 U.S.C. §§ 181-287 (1976).
8. Pub. L. No. 94-377, 90 Stat. 1083 (1975).

could be constitutionally imposed by the state in which mining occurred in the absence of specific Congressional action limiting such taxes. This note will discuss the Supreme Court's decision on the Appellants' Commerce Clause challenge and its implications for the future of mineral severance taxes.

STATE TAXATION AND REGULATION OF INTERSTATE COMMERCE BEFORE *Commonwealth Edison v. Montana*

The Supreme Court's modern analysis of state authority to levy taxes which affect interstate commerce differs from its analysis of state authority to regulate interstate commerce. In *Pike v. Bruce Church, Inc.*,[9] the Court articulated the test it has since used to determine when a state regulation which affects interstate commerce will be sustained:

> Where a state regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits. . . . [T]he extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.[10]

The Court's analysis of state taxes which affect interstate commerce has evoked "dismay and frustration"[11] because of its inconsistency. Until *Complete Auto Transit, Inc. v. Brady*[12] was decided in 1977, the Court used at least three distinct tests to determine the constitutionality of state taxing measures. After *Complete Auto,* and until the recent decision in *Commonwealth Edison v. Montana,*[13] there were still arguably two different tests.

The three separate groups of decisions on state taxes before *Complete Auto* are perhaps best represented by the cases of *Heisler v. Thomas Colliery Co.*,[14] *Western Live*

9. 397 U.S. 137 (1970).
10. *Id.* at 142. *See also* Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978); Hughes v. Oklahoma, 441 U.S. 322, 331 (1979); Minnesota v. Clover Leaf Creamery Co., 445 U.S. 949 (1981).
11. Comment, *Constitutional Limitations on State Severance Taxes,* 20 NAT. RESOURCES J. 887, 898 (1980).
12. 430 U.S. 274 (1977).
13. _____ U.S. _____, 101 S. Ct. 2946 (1981).
14. 260 U.S. 245 (1922).

Stock v. Bureau of Revenue,[15] and *Spector Motor Service v. O'Connor.*[16]

In *Heisler* and the later cases adopting its reasoning,[17] the Court heard challenges to state taxes on the value of natural resources produced within the state. The Court adopted a rather formalistic approach[18] and upheld taxes similar to the Montana severance tax on the grounds that a facially non-discriminatory tax which fell on resources prior to their entry into the stream of commerce was beyond the scope of the Commerce Clause, even though the bulk of them were ultimately shipped out of state.[19] The Court continued to cite this line of cases with approval in tax cases until as late as 1961,[20] even though the earlier rigid distinction between local and interstate activities had long since lost its force.[21]

In *Western Live Stock* the Court upheld a New Mexico statute which levied a 2% privilege tax on the gross advertising revenues of a magazine published in the state even though some of the revenues came from contracts entered into in other states and the magazines were ultimately distributed in interstate commerce. Anticipating the rationale of *Complete Auto,* the Court noted that "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 increased the cost of doing business. 'Even interstate business must pay its way.' "[22]

In *Western Live Stock* the Court held that the New Mexico tax was constitutional because the magazine was not subjected to multiple taxation: the New Mexico tax could not be repeated by any other state.[23] The tax, based on a percentage of advertising receipts, also seemed to fairly measure the value of the privilege of doing business in New Mexico.[24]

15. 303 U.S. 250 (1938).
16. 340 U.S. 602 (1951).
17. Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927).
18. Hellerstein, *Constitutional Constraints on State and Local Taxation of Energy Resources,* 31 NAT'L TAX J. 245, 246 (1978).
19. Heisler v. Thomas Colliery Co., *supra* note 14, at 259.
20. Alaska v. Arctic Maid, 366 U.S. 199 (1961) relied heavily upon Oliver Iron Mining Co. v. Lord, *supra* note 17.
21. *See* Wickard v. Filburn, 317 U.S. 111 (1942).
22. Western Live Stock v. Bureau of Revenue, *supra* note 15, at 254 (citations omitted).
23. *Id.* at 255-56.
24. *Id.* at 259.

In *Spector* a Missouri tax on the privilege of engaging in exclusively interstate commerce (trucking) was challenged.[25] The tax was held invalid, even though it was measured by apportioned net income, because it was based on the privilege of carrying on exclusively interstate business within the state.[26] The *Spector* rule, as it has been called,[27] eventually degenerated into a rule of mere draftsmanship as the Court came more and more to grips with the economic realities of state taxation of interstate commerce.[28]

The *Heisler* test allowed states to tax local activities because they were not yet in interstate commerce. *Western Live Stock,* instead of drawing a line between commerce in and commerce not in interstate commerce, focused on the potential for double taxation. *Spector* attempted to distinguish between taxes on the privilege of doing business, which were unconstitutional, and other taxes with virtually the same economic effect, which were constitutional. Any tax challenged on Constitutional grounds had to be analyzed under one or more of these three tests.

In *Complete Auto Transit, Inc. v. Brady,*[29] the Supreme Court took steps to end the confusion which resulted from the existence of three distinct tests for determining when interstate commerce could be required to pay its fair share of state taxes. In this case, the Court overruled the *Spector* line of cases and laid down a four-part test which it has consistently applied.[30] Citing *Western Live Stock* with approval, the Court said it would adhere to those decisions which have "considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not

25. Spector Motor Service v. O'Connor, *supra* note 16, at 603-604.
26. *Id.* at 609-10.
27. Complete Auto Transit, Inc. v. Brady, *supra* note 12, at 284.
28. *Id.* at 284-85. The *Spector* rule was used to declare a Virginia license tax on the privilege of doing business unconstitutional. Railway Express Agency v. Virginia, 347 U.S. 359 (1954). A modified tax was upheld after it was rewritten to charge a "franchise tax" measured by gross receipts, even though the economic effect was the same. Railway Express Agency v. Virginia, 358 U.S. 434 (1959).
29. Complete Auto Transit, Inc. v. Brady, *supra* note 12.
30. *See, e.g.,* Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979) (decided on other grounds); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980); Maryland v. Louisiana, _____ U.S. _____, 101 S. Ct. 2114 (1981) (tax struck down as discriminating against interstate commerce).

discriminate against interstate commerce, and is fairly related to the services provided by the State."[31] The Court simply stated this test with no explanation as to how its parts were to be applied.

The Court's decision in *Complete Auto* met with the approval of some Constitutional scholars as "a realistic approach to commerce clause jurisprudence" which "should be encouraged".[32] *Complete Auto* did not, however, deal directly with the limits on a state's authority to tax mineral severance.[33] About one year after the *Complete Auto* decision, Commonwealth Edison and its fourteen co-plaintiffs[34] filed their challenge to the Montana coal severance tax as an impermissible burden on interstate commerce under the *Complete Auto* test.

THE MONTANA SEVERANCE TAX CASE

A. *The Supreme Court's Reasoning*

The Supreme Court received Commonwealth Edison's appeal from the Montana Supreme Court with a minimal record to review. The trial court had granted the State of Montana's motion to dismiss. The Montana high court, relying on *Heisler,* had held the tax immune from commerce clause scrutiny, characterizing the severance of coal as a local activity which occurs before the coal enters into interstate commerce.[35] The Montana Court also noted that, even if the *Complete Auto* test

31. Complete Auto Transit, Inc. v. Brady, *supra* note 12, at 279.
32. TRIBE, AMERICAN CONSTITUTIONAL LAW 345 (1978).
33. *Complete Auto* dealt with a state income tax as it applied to a trucking firm which delivered new automobiles from the railhead to individual auto dealers.
34. The other plaintiffs-appellants are Central Ill. Light Co., Dairyland Power Coop., Detroit Edison Co., Interstate Power Co., Lake Superior District Power Co., Lower Colo. River Authority/City of Austin, Minnesota Power & Light Co., Northern States Power Co., Upper Peninsula Generating Co., Wisconsin Power & Light Co., Decker Coal Co., Peabody Coal Co., Westmoreland Resources, Inc., and Western Energy Co.
35. Commonwealth Edison Co. v. Montana, *supra* note 5, at 854. The *Heisler* line of cases had not been specifically overruled and, although it was criticized by legal scholars, Hellerstein, *supra* note 18, at 248; *Developments in the Law: Federal Limitations on State Taxation of Interstate Business,* 75 HARV. L. REV. 953, 967-68 (1962) [hereinafter cited as *Developments*]; Comment, *supra* note 11, at 905-906, state courts continued to rely on *Heisler* even after *Complete Auto* was decided. Post Oak Oil Co. v. Oklahoma Tax Comm'r, 575 P.2d 964, 967-68 Okla. 1978) (citing Oliver Iron Mining Co. v. Lord, *supra* note 17); Miami Copper Co. Div., Tenn. Corp. v. State Tax Comm'n, 121 Ariz. App. 150, 589 P.2d 24, 28-29 (1978), *cert. denied,* 441 U.S. 932 (1979) (citing Heisler v. Thomas Colliery Co., *supra* note 14); Commonwealth Edison Co. v. Montana, *supra* note 5, at 854. The Tenth Circuit also relied on these cases in Merrion v Jicarilla Apache Tribe, 617 F.2d 537, 545 (10th Cir. 1980), *U.S. decision pending,* No. 80-11 (scheduled for reargument, July 2, 1981).

did apply to the coal severance tax, the "plaintiffs could not prevail as a matter of law".[36]

The Montana Court summarily disposed of the first three prongs of the *Complete Auto* test.[37] Focusing on the "fairly related" portion of the test,[38] the Montana Court found that "[i]t is only when the taxpayer has an insufficient nexus to the taxing state [first prong], or the tax is disproportionate to the incidents of commerce being taxed [second prong], that the fair-relation test [fourth prong] applies."[39] According to the Montana Supreme Court, the severance tax could be upheld under either the *Heisler* rule or under the *Complete Auto* test.

On review, the United States Supreme Court held that a state severance tax *is* subject to scrutiny under the Commerce Clause and "disapproved" of any "contrary statements in *Heisler* and its progeny".[40] The Court then proceeded to apply the *Complete Auto* test, observing that the "Appellants [did] not dispute that the Montana tax satisfies the first two prongs" of the test.[41] The only possible site of severance of the coal is in Montana so the nexus requirement is met; the apportionment requirement is met because the severance of coal could only occur in Montana, making multiple taxation of the severance impossible.

In applying the third prong of the *Complete Auto* test, the Court addressed the Appellants' contention that, since the tax burden is borne primarily by out-of-state consumers, it discriminates against interstate commerce.[42] The Supreme Court held that, because 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" it does not discriminate against interstate commerce.[43]

36. Commonwealth Edison Co. v. Montana, *supra* note 5, at 855.
37. *Id.*
38. *See* text accompanying note 31 *supra.*
39. Commonwealth Edison Co. v. Montana, *supra* note 5, at 856.
40. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2953. The Court also noted that it did not mean to "suggest, however, that *Heisler* and its progeny were wrongly decided." *Id.* at 2953, n.7. Presumably the Court meant that the *Heisler* opinion had reached a proper result in upholding the Pennsylvania coal tax.
41. *Id.* at 2954.
42. Appellants argued that since 90% of the coal mined in Montana is shipped out-of-state, consumers in other states bear an unfair proportion of Montana's tax burden. Brief of Appellants, *supra* note 2, at 33-34.
43. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2954.

The Court also rejected the Appellants' offer to prove that the tax did not meet the fourth prong of the *Complete Auto* test in that the amount of the tax is not "fairly related to the services provided by the State."[44] The Court said that the Appellants' argument on this issue rested on the invalid premise that the *amount* of the tax must be fairly related to either the additional costs the State incurs because of coal mining or to the actual value of State services provided to the coal industry.[45]

Noting that the fourth prong of the *Complete Auto* test is "closely connected" with the first prong (nexus), the Court said that the fourth prong "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the contact [with the taxing 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 the state tax burden'."[46] The Court held finally that, since it is measured as a percentage of the value of the coal taken, the Montana severance tax satisfies the fourth prong of the *Complete Auto* test.[47]

B. The Complete Auto Test Applied

The nexus requirement of the first prong of the *Complete Auto* test is similar to the "minimum contacts" requirement for the exercise of state court jurisdiction over nonresidents.[48] It is a sort of "jurisdiction to tax" standard. This standard appears to be quite loose in modern cases. In *Mobil Oil Corp. v. Commissioner of Taxes*[49] the Court held that the nexus requirement is met if the taxpayer does business within the state.[50]

44. Complete Auto Transit, Inc. v. Brady, *supra* note 12, at 279.
45. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2955-56. The Appellants had conceded that some degree of tax on coal severance was permissible and had offered to show that a reasonable tax rate would be 2¢ per ton, rather than the approximately $2.00 per ton raised by the 30% tax. Brief of Appellants, *supra* note 2, at 12.
46. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2958 (citations omitted) (emphasis in original).
47. *Id.*
48. TRIBE, *supra* note 32, at 347-48.
49. 445 U.S. 425 (1980).
50. *Id.* at 437. *Accord,* Japan Lines, Ltd. v. County of Los Angeles, *supra* note 30, at 445; Exxon Corp. v. Wisconsin Dep't of Revenue, *supra* note 30, at 220. *See also* Connecticut Gen. Life Ins. Co. v. Johnson, 303 U.S. 77, 80 (1937), where the Court said it would "look to the state power to control the objects of the tax as marking the boundaries of the power to lay" the tax. The *Connecticut Gen. Life Ins. Co.* case declared a California tax on the proceeds of reinsurance policies issued in Connecticut to California insurance companies invalid under the Due Process Clause because there was no relationship between the transactions taxed and the taxing state.

There was really no issue as to the application of the nexus requirement in *Commonwealth Edison v. Montana.* Montana taxed the severance of coal in Montana. " '[T]here can be no argument here that a substantial, in fact, the only nexus of severance of coal is established in Montana'."[51]

The second requirement, that a tax be fairly apportioned, was not new to *Complete Auto.* The Court had approved state taxes based on a percentage of the gross income of corporations involved in interstate commerce where the state made some attempt to approximate the portion of corporate income reasonably related to activities within the taxing state.[52] The Court's main aim in requiring fair apportionment is to protect interstate commerce from the possibility of mutliple taxation by the imposition of taxes which were "capable, in point of substance, of being imposed . . . with equal right by every state which the commerce touches, merely because interstate commerce is being done."[53] The cumulative burden of unapportioned taxes would surely impede interstate commerce by subjecting it to a greater tax burden than that levied on strictly intrastate businesses. The Montana coal severance tax is, by definition, incapable of being repeated in any other state. Coal can be severed only once and only Montana can tax that severance when it happens in Montana.

The Court's analysis of apportioned taxes is not without flaw given its goal of avoiding multiple taxation. Even though the severance of Montana coal can be taxed only by Montana, the tax is measured as a percentage of contract sales price. Those coal producers which do business in more than one state are nevertheless subject to income taxes on their total gross revenues in any state in which they do business. Even the use of some sort of apportioned tax designed to tax only that portion of income reasonably related to business conducted within the state does not guarantee that multi-state operations will not be taxed more than once on the same income, resulting in a sort of double taxation. A great deal depends on the apportionment formulas used by the individual states to determine the tax liability of the taxpayer.[54]

51. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2954 (quoting Commonwealth Edison Co. v. Montana, *supra* note 5, at 855).
52. Western Live Stock v. Bureau of Revenue, *supra* note 15, at 255-56.
53. *Id.*
54. A survey published in 1960 found that 14% of the responding companies paid taxes on more total income than they actually earned because of the operation of the state apportionment formulas. *Developments, supra* note 35, at 966 n.67 (citing CONTROLLERS INSTITUTE OF AMERICA, A DECADE OF PROGRESS REGARDING MULTIPLE TAXATION ON INCOME FROM INTERSTATE COMMERCE 27 (1960)).

The Court's recent decision in *Exxon Corp. v. Wisconsin Department of Revenue*,[55] while purporting to examine the practical effect of an apportioned income tax under the *Complete Auto* test, held that in the case of an "integrated business" the taxpayer must show that its "functional departments" are so separate from any activity within the taxing state that they form "discrete business enterprises".[56] Exxon attempted to show by a separate internal accounting procedure that income from its exploration and production operations should not be taxed in Wisconsin because only marketing operations were conducted in Wisconsin. The Supreme Court held that, even though Exxon only marketed and did not explore for or produce petroleum products within Wisconsin, the State could apply its apportionment formula to income from all three operations to determine Exxon's state tax liability.[57]

It would appear that the Court has not successfully dealt with the economic consequences of allowing any state in which a multi-state corporation does business tax according to its particular apportionment formula. As long as a corporation has a unified management function, any state in which it does business can tax a proportion of its entire income, whether or not that income is obtained from operations in the taxing state. A coal company which operates in Montana and other states, for example, must pay 30% of the contract sales price of coal mined in Montana to the State of Montana in severance tax. The same income from the same sales contracts is also taxable *as income* in any other state in which the company does business so long as the state uses some sort of apportionment formula.

The Supreme Court's analysis of the third prong of the *Complete Auto* test—the requirement that the tax not discriminate against interstate commerce—is consistent with the first step of its analysis of state regulatory measures which affect interstate commerce. The Court, having determined that the tax is neutral on its face, made no further inquiry into the actual operation of the tax. After declaring its intention to

55. Exxon Corp. v. Wisconsin Department of Revenue, *supra* note 30.
56. *Id.* at 224.
57. *Id. Accord,* Mobil Oil Corp. v. Commissioner of Taxes, *supra* note 30. The Court reasoned in both cases that the separate internal accounting of income did not necessarily take into account the money saved by the unified management and purchasing functions of an integrated business.

examine "the practical effect of a challenged tax", the Court stopped short of doing so.[58] The dissenters argued that the analysis should go beyond the wording of the statute, and consider whether the tax actually burdens or interferes with interstate commerce.[59]

The Appellants had argued that Montana and other western states are attempting to exploit their "monopoly" on low-sulphur coal by exporting their tax burden out of state,[60] in violation of the free trade principles embodied in the Commerce Clause.[61] The factual questions involved in determining whether the Montana tax actually operates to impose a barrier to free trade are monumental. The threshold question might be, "Is the state actually in a position, because of a monopoly on low-sulphur coal, to impede the free flow of interstate commerce, or will coal consumers merely go elsewhere if Montana taxes get too high?" The next question might be, "Does the 30% tax rate actually operate to restrict out-of-state consumption?"[62] The Court itself recognized this type of analysis poses difficult evidentiary questions which might render the Court's search for answers "futile".[63]

The Supreme Court has looked to the practical operation of a facially neutral state tax in at least one earlier case. In *Nippert v. City of Richmond*,[64] the Court held that an annual city license fee imposed on solicitors was a burden on interstate commerce in violation of the Commerce Clause because it unduly burdened interstate businesses. The Court then looked behind the wording of the ordinance to the operation of the tax and found that, even though it was facially neutral, it operated to exclude small out-of-state operators who could not afford the cumulative burden of license taxes.[65]

The decision in *Commonwealth Edison v. Montana* seems to indicate the Court's unwillingness to involve the judiciary in

58. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2953.
59. *Id.* at 2968.
60. *Id.* at 2954-55.
61. Hellerstein, *supra* note 18, at 249-50.
62. *Id.* at 248-50. *Developments*, *supra* note 35, at 968-70.
63. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2955 n.8.
64. 327 U.S. 416 (1945).
65. *Id.* at 428. The Court has gone beyond the mere wording of a facially neutral statute in cases where a state is regulating, as opposed to taxing, interstate business. *See, e.g.*, Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959); Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429 (1978).

the complex factual questions involved in determining the economic operation of various, often conflicting, state taxes. This unwillingness is also reflected in the Court's analysis of the fourth prong of the *Complete Auto* test—the requirement that the tax be fairly related to the services provided by the state.

The Appellants insisted that the fourth prong of the *Complete Auto* test contemplates a factual determination by the trial court that the rate of the Montana severance tax was or was not fairly related to the services provided by the state. They claimed that if the only measure of services referred to in the fourth prong of the test is the provision of the "advantages of a civilized society", the "test has no real meaning because it can be met by any state and under all circumstances."[66] The majority found that the benefits of a civilized society were indeed all the Appellants or any other taxpayer could ask from a state and that "[b]ecause it is measured as a percentage of the value of the coal taken, the Montana tax is in 'proper proportion' to appellants' activities within the State and, therefore, to their 'consequent enjoyment of the opportunities and protections which the state has afforded' in connection with those activities".[67]

As the dissent aptly points out, the majority's interpretation of the fairly related test is a return to the mechanical approach of *Heisler* even though the Court had rejected such an approach in *Complete Auto.*[68] The fourth prong also becomes a rule of drafting similar to the rejected *Spector* rule: States are free to impose whatever severance tax they wish, free from Commerce Clause scrutiny, so long as they impose a proportional, rather than a flat rate, tax.

The Supreme Court held that a determination of the level or rate of taxation is a matter for legislative, and not judicial, determination.[69] Given the extensive economic analysis required to make even an approximate judgment as to what is a "fair relation" between tax rates, tax revenues, and services provided, and given the policy considerations inherent in any

66. Brief of Appellants, *supra* note 2, at 29-30.
67. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2958-59.
68. *Id.* at 2968.
69. *Id.* at 2959.

such analysis, the Court is probably correct in seeing this as a question for the legislature. The Court's rationale here is also consistent with earlier decisions which, when asking whether a state has given anything to interstate commerce for which it can ask return, refer to the "substantial privilege" of carrying on business within the state without discussing the specific services provided by the state to the taxpayer.[70] As the majority correctly points out, a taxpayer has never been able to successfully challenge the rate of a tax because she is not benefitted in an amount equal to the amount of the tax.[71]

THE IMPLICATIONS OF THE *Commonwealth Edison v. Montana* DECISION

The Montana severance tax, coming as it did in the wake of the 1973 Arab oil embargo and the rather frantic search for homegrown sources of energy, has not been popular, especially with coal consumers. The utility and coal producer plaintiffs were supported by six amicus briefs in the Supreme Court, mostly representing coal-consuming states.[72]

The unpopularity of the severance tax among Montana's sister states is particularly important in light of the Supreme Court's clearly extended invitation to Congress to legislate a ceiling on severance tax rates.[73] As the Court noted in its opinion, the idea of a severance tax ceiling received some attention from the 96th Congress before this case was decided.[74] There are currently two bills pending before the 97th Congress to amend the Powerplant and Industrial Fuel Use Act of 1978[75] to limit the permissible rate of severance taxes. Senate

70. Wisconsin v. J. C. Penney, 311 U.S. 435, 444-45 (1940).
71. Commonwealth Edison Co. v. Montana, *supra* note 13 (citing Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937)). Applying *Carmichael*, 301 U.S. at 521, there need not be a relation between the subject of the tax (here, severance of coal in Montana) and the evil to be met by the apportionment of the tax (whether the tax is to raise revenues for general governmental support or to alleviate the impact of coal development).
72. Amicus briefs were submitted by the State of Texas; the Crow Tribe of Indians; several midwestern and northeastern Congressmen; the States of New Jersey and Michigan; the States of Minnesota, Iowa, Wisconsin; and the State of Kansas on behalf of the appellant corporations. Amicus briefs were submitted by the members of the Wyoming congressional delegation; the States of North Dakota and West Virginia; the Environmental Defense Fund, the Natural Resources Defense Council, and the Sierra Club; the State of New Mexico; several western Congressmen; the Western Governors' Policy Office; the Western Conference of Council of State Governments; and the States of Wyoming, Colorado, Nevada, Idaho, Washington, and Oregon on behalf of the State of Montana. The Solicitor General of the United States also submitted a brief arguing that the tax should be upheld.
73. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2959.
74. *Id.* n.18.
75. 42 U.S.C. § 8301(b)(3) (Supp. III 1979).

bill S. 178[76] proposes to limit "the sum of all severance taxes, or fees, in respect of any fiscal year, imposed by a State or political subdivision" of a state to 12½% of the value of coal mined "from Indian lands or lands owned by the Federal Government which is destined for shipment in interstate commerce". The House version of the bill, H.R. 1313,[77] not limited to coal mined on Indian or Federal lands, also includes a 12½% of value limit on severance taxes or fees. Both bills are now in committee.

If Congress acts in response to the Court's invitation to pass a ceiling on severance taxes, the validity of such a ceiling will certainly be questioned. The *Commonwealth Edison v. Montana* decision also has ramifications for the future of state taxes in general.

A. Congress' Constitutional Authority to Limit the Rate of State Severance Taxes

The Court seems to find Congress' authority to limit the rate at which states may tax the severance of minerals in the Supremacy Clause and in those other provisions of the Constitution which reserve particular powers to the national government, notably the Commerce Clause. Any Congressional limit on the maximum level of state severance taxes must, however, be in the form of an "explicit directive from Congress" because "[c]oncurrent federal and state taxation" is the accepted norm.[78]

Congress has enacted at least one statute which does limit the right of states to tax interstate business.[79] This statute prohibits states from taxing the net income of foreign corporations whose only business within the state is the solicitation of orders to be filled elsewhere. The State of Louisiana challenged the constitutionality of this statute in *International Shoe Co. v. Cocreham* in 1964.[80] The Louisiana Supreme Court upheld the prohibition on state taxes, relying on the Commerce and Supremacy Clauses of the Constitution.[81] The U.S.

76. S. 178, 97th Cong., 1st Sess. (1981).
77. H.R. 1313, 97th Cong., 1st Sess. (1981).
78. Mobil Oil Corp. v. Commissioner of Taxes, *supra* note 30, at 448.
79. 15 U.S.C. §§ 381-384 (1976). *See also* 15 U.S.C. § 391 (1976) prohibiting states from levying taxes which discriminate against out-of-state consumers of electricity, either directly or indirectly.
80. 246 La. 244, 164 So. 2d 314 (1964), *cert. denied*, 379 U.S. 902 (1964).
81. *Id.* at 164 So. 2d at 318, 320-21.

Supreme Court denied certiorari and let the state court's decision stand.[82]

The significant distinction between the statute upheld in *International Shoe* and one limiting state taxes on mineral severance appears to be that Congress, having found that state taxes burdened an industry which was exclusively involved in interstate commerce, chose to prohibit taxing of those businesses in this particular instance. Mineral severance would be exclusively interstate commerce only if none of the minerals were consumed in the state where mined. To the extent that the minerals are consumed within the state, they would theoretically not be in interstate commerce and perhaps not subject to Congressional limits on severance taxes.

The distinction between minerals consumed within and without the state where they are mined is probably not important to the determination of whether or not Congress can limit state severance taxes. The Supreme Court has approved the extension of Congress' power to regulate interstate commerce to even what would appear to be the most "local" of activities on the grounds that they affect the interstate market.[83] The Court is likely to sustain some Congressional limit on state severance taxes, whether applied to coal consumed in or out of the state, on Commerce Clause grounds.

A federal statute which prohibits states from levying discriminatory taxes on the generation or transmission of electricity for out-of-state consumption[84] was upheld on Supremacy and Commerce Clause grounds in *Arizona Public Service Commission v. Snead.*[85] The Arizona Public Service Commission challenged a New Mexico tax on the generation of electricity as discriminatory and, therefore, in violation of the federal statute because New Mexico utilities were allowed to off-set the 2% generation tax by an equal credit against the New Mexico retail sales tax when the electricity was sold for consumption in New Mexico.[86]

82. *See* note 80 *supra.*
83. *See, e.g.*, Wickard v. Filburn, *supra* note 21, where the production of small quantities of grain for home use was held to affect interstate commerce and be, therefore, within the power of Congress to regulate.
84. 15 U.S.C. § 391 (1976).
85. 441 U.S. 141 (1979).
86. *Id.* at 144-45. Out-of-state purchasers were guaranteed no such sales tax set-off.

The Court's application of the Supremacy Clause pointed to a legislative history which showed that Congress had passed this Act with the New Mexico tax in mind.[87] The Court declined to look at the entire tax structure of the state of New Mexico and instead looked "not only to the language of that [federal] statute but also to the expressed intent of Congress itself in enacting it".[88] Finding that Congress had a "rational basis" to believe that the New Mexico tax interfered with interstate commerce and that Congress had selected a reasonable means to eliminate that perceived interference, the Court upheld the federal statute as within the permissible bounds of Congress' authority to regulate interstate commerce.[89]

This opinion, in dictum, noted that Congress had *not* attempted to prevent New Mexico from taxing electrical generation to help pay for environmental and other problems caused by the generating facilities in New Mexico. Congress merely sought to end tax discrimination against out-of-state consumers.

The value of *Arizona Public Service Commission* as an indication of how the Court might resolve a state challenge to a Congressional limitation on coal severance taxes is two-fold: first, it sets forth the test the Court will apply to determine when Congress can override state taxes by federal statute; and, secondly, it hints that there may be limits to Congress' authority to eliminate or limit state taxes.

The test of the constitutionality of Congress' exercise of its Commerce Clause authority vis-á-vis state taxes is not a difficult one for Congress to meet. If Congress has a *rational basis* for determining that the tax interferes with interstate commerce and uses a *reasonable method* to eliminate this interference, the Court will uphold the limitation.[90] Note that the standard does not require Congress to find that the tax discriminates against interstate commerce. This standard differs in that regard from the *Complete Auto* test by which courts will evaluate state taxes.

87. *Id.* at 147-48.
88. *Id.* at 149-50.
89. *Id.* at 150.
90. *Id.*

In *Arizona Public Service Commission*, the Court also limited its review of Congress' determination that the tax interfered with interstate commerce to the legislative history of the federal statute and refused to look to the entire tax structure of the state to make an independent judgment as to the operation of the tax.[91] The Court apparently has determined to accord great deference to Congress in its efforts to limit state taxes in light of the potentially significant impact state taxes can have on interstate commerce.

Each of the two bills to limit severance taxes on coal which are currently before the 97th Congress cites enhancing interstate commerce as one of its purposes. *Arizona Public Service Commission* indicates that the Supreme Court will defer to Congress' decisions as to whether or not state taxes interfere with interstate commerce. The Court can easily rely on the language of either of these bills, if passed, to find Congress' view that any severance tax over the rate of 12½% does interfere with interstate commerce. Finding such a legislative determination might well end the Court's inquiry, except perhaps to note that a limitation on tax rates is a reasonable way for Congress to eliminate the burden on commerce.

Deference to a Congressional determination in setting a tax ceiling is consistent with the Court's opinion in *Commonwealth Edison v. Montana*.[92] The Court recognized in that opinion that the amount of a tax is a question for legislative determination, even at the national level, if Congress thinks that particular state taxes are contrary to national interests.[93]

In summary, it appears that a federal ceiling on state coal severance taxes will not receive strict scrutiny by the federal courts. The courts will look to the language of the federal limit and to its legislative history to see if Congress perceived the particular state tax as a burden on interstate commerce. If Congress had a rational basis for its belief that the tax was a burden and used a reasonable means to eliminate the burden, the tax ceiling will stand.

91. *Id.* at 149.
92. *See* note 13 *supra*.
93. *Id.* at 2959. Both H.R. 1313 and S. 178 also state that the proposed limit on state severance taxes is required to "alleviate the national energy emergency [and to] reduce national dependence on petroleum imports", as well as to enhance interstate commerce.

The possible limits on Congress' authority to prohibit a particular state tax altogether are alluded to in dictum at the end of the *Arizona Public Service Commission* decision. The Court notes that "[t]here is no indication that Congress intended to prevent the State from taxing the generation of electricity to pay for solutions to [environmental and other] problems".[94] If Congress were to place an outright prohibition on severance taxes or to place an unreasonably low ceiling on them, the states could argue persuasively that Congress was, in effect, interfering with a function essential to the state's separate and independent existence.

Applying the Court's earlier decision in *National League of Cities v. Usery*,[95] an absolute prohibition on state severance taxes could be attacked as an unconstitutional Congressional attempt to impair an essential attribute of state sovereignty—the power to tax.[96] Unlike the federal statute in question in *National League of Cities*,[97] an absolute ban on state severance taxes would not impose additional costs on states, except to the extent that it would deprive them of a significant source of tax revenues.[98] It would, however, drastically curtail state activity directed to alleviating the impact of mineral development by eliminating such a significant source of revenue.

A total ban on mineral severance taxes seems too extreme for Congress to even consider. A much more likely issue is the question of how low a ceiling Congress can enact before the Court would overrule it under *National League of Cities*. Both bills pending before Congress now propose a ceiling of 12½%. The Court would have to strike some sort of balance between Congress' power to regulate interstate commerce and the State's power to exercise its sovereignty through taxing. To strike this balance, the Court would once more be placed in

94. Arizona Public Service Comm'n v. Snead, *supra* note 85, at 150-51.
95. 426 U.S. 833 (1976).
96. *Id.* at 845.
97. In *National League of Cities*, the Court declared unconstitutional a federal statute which extended the minimum wage and maximum hours provisions of the Fair Labor Standards Act, 29 U.S.C. § 203 (1976), to the employees of states and their political subdivisions.
98. Montana collected over $5.4 million in severance taxes from the Appellants in Commonwealth Edison Co. v. Montana alone between 1975 and 1978. Some estimates say that the State of Montana will receive severance tax revenues on all minerals of about $80 million in 1981 and $128.7 million by 1983. Wyoming is expected to receive about $137.9 million in 1981 and $549.1 million by 1985. Whipple, *Severance Taxes*, High Country News, July 10, 1981, at 10, col. 1.

the position it tried to avoid in *Commonwealth Edison v. Montana:* that of evaluating the rate at which a state should be able to tax coal severance.

B. State Taxes in General after Commonwealth Edison v. Montana

The Supreme Court's decision in *Commonwealth Edison v. Montana* has implications for general state revenue taxes.[99] Several of these implications seem clear:

—The state's authority to tax extends even to enterprises which are engaged wholly in interstate business.[100]

—State legislatures should draft taxing statutes to levy a proportional, rather than a flat rate tax, on revenues to meet the "fairly related" test.[101] This portion of the *Complete Auto* test has thus become a combination of the "nexus" test and a requirement that the tax be proportional to revenue raised from the activity which provides the taxing state with a nexus.

—State taxes must also be drafted so that they do not discriminate against interstate commerce on their face. A facially neutral tax will not receive strict scrutiny to determine whether its real economic effect is to burden or interfere with interstate commerce.[102]

The Court now has one test for reviewing state taxes: the *Complete Auto* test. *Heisler,* with its distinctions between commerce which is in and commerce which is out of the stream of interstate commerce, is officially dead.

After *Commonwealth Edison v. Montana,* challenge to state taxes may be easily adjudicated before trial so long as the

99. The court was careful to distinguish user fees or taxes from general revenue taxes, thus preserving an earlier line of cases which required that the fees charged by a state be proportionate to the services rendered. The Court seems to believe that user taxes are different from ordinary tax measures in that they are related to and based on specific services provided by the state to the taxpayer and, therefore, are more readily evaluated in quantitative terms. Commonwealth Edison Co. v. Montana, *supra* note 13, at 2956.

100. *See, e.g.,* Complete Auto Transit, Inc. v. Brady, *supra* note 12.

101. *See* text accompanying notes 66-69 *supra.*

102. Compare the treatment of state taxes in *Commonwealth Edison* with that in Maryland v. Louisiana, *supra* note 30, and Arizona Public Service Comm'n v. Snead, *supra* note 85. Taxes perceived as discriminatory on their face because of tax breaks to local users may be *per se* unconstitutional.

tax law is drafted in compliance with *Complete Auto* and *Commonwealth Edison* in mind. The "nexus" portion of the test may pose the only real factual problems. The trial court might need to take evidence to determine, in questionable cases, if the taxpayer has minimum contacts or is doing business within the state.[103]

The fair apportionment requirement of the test will ordinarily be a question of fact only if the tax in question is capable of being imposed equally by all states which the taxed commerce touches. Mere speculation will not be enough; the taxpayer will have to allege a specific instance of multiple taxation.[104] If a state tax, like the Montana severance tax, is measured by the income received from activities conducted within the taxing state, apportionment poses no factual questions.[105]

CONCLUSION

Montana's 30% severance tax was upheld in the face of Commerce Clause and Supremacy Clause challenges in *Commonwealth Edison v. Montana.* The *Heisler* test was laid to rest and the *Complete Auto* test was reaffirmed. Challenged state tax measures will be reviewed to see if they meet the four-part *Complete Auto* test. That test does not place stringent limits on state tax laws so long as they meet the requirement that the tax be proportional.

While Montana has certainly won this round in the fight to retain its right to tax mineral resources, the Court's decision recognizes that the fight is not over. The next, and potentially more difficult, task facing coal-producing states is to prevent this victory from being taken away by Congressional action.

CHRISTINE CHUTE

103. *See* text accompanying notes 50-53 *supra.*
104. Mobil Oil Corp. v. Commissioner of Taxes, *supra* note 30.
105. *See* text accompanying notes 54-59 *supra.*