The Louisiana Hydrocarbon Processing Tax

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I. INTRODUCTION

One of the most controversial measures considered by the Louisiana Legislature during the 2000 Regular Session was Senate Bill Number 1, which was proposed to amend the Louisiana Constitution to repeal the severance tax imposed on the extraction of oil and gas in Louisiana and to commence levying a tax on the use of hydrocarbon processing facilities located in Louisiana. The hydrocarbon processing tax concept was opposed by the oil and gas industry that declared that the new tax "would add a cost to their operations that would make their products uncompetitive and speed the decline of the refining industry in Louisiana." Proponents hailed the hydrocarbons processing tax as the answer to Louisiana's recurring fiscal problems, noting that "[a]fter accounting for the elimination of severance taxes, the state would have about $700 million a year to take care of the budget problems and education, including teacher pay raises." Both sides made presentations to the Louisiana State Law Institute Tax Study Committee that was charged with the responsibility to "study and investigate particular areas of tax laws in Louisiana at the direction of and in consultation with the joint committee (House Ways and Means/Senate Revenue and Fiscal Affairs) and report to the joint committee in the manner and as requested by the joint committee." Ultimately, the Tax Study Committee rejected the hydrocarbon processing tax idea.

Louisiana's recent effort to impose a tax on hydrocarbon processing in Louisiana was not new. It had its vestiges in two failed past efforts to implement such a tax—the 1978 "First Use Tax" and the 1982 "Coastal Wetlands Environmental Levy" ("CWEL"). The former measure was declared

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Shareholder, Liskow & Lewis, A Professional Law Corporation, New Orleans, Louisiana.
2. Id. at Art. VII, § 4(B); La. R.S. 47:631 (2000).
3. Carl Redman, Tax Plans Advance at Capitol, Baton Rouge Morning Advocate, May 24, 2000, at 6A.
4. Id.
5. The Committee was born out of S. Con. Res. No. 88, 1999 Leg. Reg. Sess. (La. 1999). Executive Director of the Louisiana State Law Institute William Crawford assembled an eighteen member volunteer Tax Study Committee chaired by former Louisiana Senate President Randy Ewing. The Tax Study Committee was composed of academics, business and tax lawyers, certified public accountants, economists, lobbyists and businessmen from around the state.
6. Id.
unconstitutional by the United States Supreme Court in *Maryland v. Louisiana.*\(^{10}\) The latter measure did not make it out of the 1982 Regular Session of the Louisiana Legislature.\(^{11}\) The 2000 Regular Session of the Louisiana Legislature likewise rejected Senate Bill Number 1.\(^{12}\)

Despite the defeat of Senate Bill Number 1, few observers believe a tax levied on hydrocarbon processing is dead. Because of its potential economic impact on the State of Louisiana, the concept of a hydrocarbon processing tax will undoubtedly be refined and reintroduced again. Pretermitting the political and economic soundness of Senate Bill Number 1, passing contemporary constitutional muster remains one of the formidable obstacles to future efforts to levy a tax on hydrocarbon processing in Louisiana.

Evaluating the constitutionality of a hydrocarbon processing tax begins with an understanding of the approach taken in Senate Bill Number 1. Its drafters attempted to address the constitutional infirmities of the First Use Tax identified in *Maryland v. Louisiana* and the academic debate surrounding the constitutionality of CWEL. Whether those remedial measures would have been sufficient for Senate Bill Number 1 to sustain a constitutional challenge requires an appreciation of the development of the jurisprudence surrounding federal constitutional limitations on a state’s authority to tax over the past two decades. After a survey of this jurisprudence, one can then frame and measure the constitutional issues emanating from Senate Bill Number 1.

**II. THE TAXING SCHEMES**

**A. Scope and Characteristics of the Hydrocarbon Processing Tax**

The scope of the hydrocarbon processing tax was intended to extend to the “use of hydrocarbon processing facilities in Louisiana by the owners of the hydrocarbons processed therein.”\(^{13}\) The term “use of hydrocarbon processing facilities” was defined as processing, or causing to be processed, hydrocarbons in a hydrocarbon processing facility in Louisiana.\(^{14}\) The term “hydrocarbon processing facility” meant any plant, building, construction, structure, or equipment located in Louisiana and used to perform all or part of the processes, procedures, or operations involved in “hydrocarbon processing.”\(^{15}\) However, the terms did not include motor

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12. *See supra* note 1. After significant amendments, progress on Senate Bill Number 1 halted on June 1, 2000 with a 17 yeas, 22 nays by Senate floor vote on final passage.
14. *Id.* at § 4.1(E)(11).
15. *Id.* at § 4.1(E)(6).
vehicles, railway cars, ships, barges, or vessels. "Hydrocarbon processing" was broadly defined to include any process, procedure, or operation by which a hydrocarbon or mixture of hydrocarbons undergoes any one of more than thirty specifically described events in Louisiana, ranging from very specific and complex chemical treatments such as catalytic reactions to very general physical processes such as measurement by pressure, velocity, or flow. The direct venting or flaring into the atmosphere of gas produced from oil and gas wells was specifically excluded from the definition of "hydrocarbon processing."

The term "owner" referred to the person or persons having title to the hydrocarbons at the time they are processed in hydrocarbon processing facilities in Louisiana. The term "hydrocarbon" was specifically defined as a chemical compound containing atoms of both carbon and hydrogen, including, but not limited to crude oil, condensate, natural gas, natural gas liquids, and any refined petroleum products. The term "hydrocarbon" specifically excluded petrochemicals, coal, lignite, materials derived from agriculture or forestry products, or nitrogenous fertilizers. "Refined petroleum products" included any substances derived from refining petroleum which have commercial value such as oils, gasoline, diesel, jet fuel, naphtha, kerosene or asphalts. The term "petrochemicals" meant any products other than refined petroleum products and were typically single chemical compounds produced from a chemical process in which petroleum was used.

The tax was to be levied at the rate of six cents per thousand cubic feet of natural gas and natural gas liquids which undergo hydrocarbon processing in a hydrocarbon processing facility within Louisiana. It was to be levied at the rate of $1.25 per barrel of condensate, crude oil, and natural gas liquids or condensate contained therein, which had undergone hydrocarbon processing in a hydrocarbon processing facility within Louisiana. The rate was 1.15 times the rate for crude oil, per barrel of refined petroleum products that underwent hydrocarbon processing in a hydrocarbon processing facility. The initial rates of the tax were to be only a floor and would have been indexed and adjusted annually based on the price of hydrocarbons during the previous year. The rates would have only been reduced below the floor rates upon a vote of two-thirds of the Legislature. The Legislature

16. Id.
17. Id. at § 4.1(E)(5).
18. Id.
19. Id. at § 4.1(E)(8).
20. Id. at § 4.1(E)(4)(a).
21. Id. at § 4.1(E)(4)(b).
22. Id. at § 4.1(E)(4)(a).
23. Id. at § 4.1(E)(4)(b). These products are generally used as materials in the manufacturing of other finished products.
24. Id. at § 4.1(A)(3)(a).
25. Id. at § 4.1(A)(3)(b).
26. Id. at § 4.1(A)(3)(c).
27. Id. at § 4.1(A)(4).
28. Id. at § 4.1(A)(5).
also had the ability to increase or decrease the price-index rates with a two-thirds vote of each house.  

The owner or operator of the facility in which the hydrocarbons were processed would have had to collect the tax due from the owner of the hydrocarbons and remit them monthly. Owners and operators of hydrocarbon processing facilities who neglected, failed, or refused to collect or remit the tax due would have been liable for the full amount of such taxes, interest and penalties that should have been collected and remitted. Purchasers of hydrocarbons upon which the tax had not been paid would have had to deduct the tax due from the amount due to the owner. Purchasers who failed to deduct or withhold the amount of taxes due also would have been liable for the full amount of such taxes, interest and penalties that should have been deducted and withheld. The tax liability due would have operated as a first lien and privilege on the hydrocarbons of the owner from whom the tax was due. The first lien and privilege of the hydrocarbons would have followed the hydrocarbons into the hands of third persons regardless of good or bad faith and regardless of whether the hydrocarbons were in a manufactured or unmanufactured state. 

Once an owner of hydrocarbons had paid the tax, no further tax would have been due from that owner or any subsequent owner of the processed hydrocarbons. This provision essentially limited the imposition of the processing tax to the first processing of the hydrocarbons within Louisiana. Owners who had paid a similar tax to another state for using hydrocarbon processing facilities to process hydrocarbons subsequently imported into Louisiana would have received a credit against the tax. The Louisiana tax credit only would have been valid if the other state, which had imposed the original processing tax, granted a similar credit. 

The tax provided exemptions for "wells with minimal production capabilities," which were intended to encourage "national oil and gas production from wells with minimal production capabilities." For the exemptions to apply, the owners of the hydrocarbons that were processed at Louisiana facilities must have obtained the hydrocarbons from one of four specifically identified categories of wells including: (1) any well incapable of producing more than twenty-five barrels of oil per producing day during an entire month of operation and which produces at least fifty percent salt water per day, (2) any well determined to be a "stripper well," (3) gas produced from a

29. Id. 
30. Id. at § 4.1(D)(2)(a). 
31. Id. at § 4.1(D)(2)(b). 
32. Id. at § 4.1(D)(2)(a). 
33. Id. at § 4.1(D)(2)(b). 
34. Id. at § 4.1(D)(3). 
35. Id. 
36. Id. at § 4.1(C)(1). 
37. Id. at § 4.1(C)(2). 
38. Id. 
39. Id. at § 4.1(A)(6). 
40. Id. 
41. Id. at § 4.1(A)(6)(i). 
42. Id. at § 4.1(A)(6)(ii). A "stripper well" is an oil well incapable of producing an average of
well with a "well head pressure" of fifty pounds per square inch gauge or less under operating conditions, or, gas rising in a vaporous state through the annular space between the casing and tubing of such oil well and released through lines connected with the casing head gas which has been determined to have a casing head pressure of fifty pounds per square inch gauge or less under the operating conditions for an entire month, and (4) any gas well incapable of producing an average of 250,000 cubic feet of gas per day during an entire operating month.

In addition to a repeal of the severance tax levied on oil and gas, Senate Bill Number 1 also provided an elaborate procedural mechanism for court challenges to the tax and a severability clause.

The hydrocarbon processing tax possessed attributes of both an excise tax and an ad valorem tax. An excise tax typically is imposed upon a specifically identified transaction and is measured by the consideration paid for the transaction. Ad valorem taxes are imposed upon the presence of property on a given date and are measured by the value of the property taxed. The hydrocarbon processing tax combined these characteristics because it was to be imposed upon the "use of hydrocarbon processing facilities" but was to be measured by the volume and value of the hydrocarbon at a given time. In Hunt-Wesson, Inc. v. Franchise Tax Board of California, the U.S. Supreme Court recited a tax axiom that "a tax on sleeping measured by the number of pair of shoes in your closet is a tax on shoes." Under this reasoning, the practical effect of the hydrocarbon processing tax resembled a tax on property. Of the more than thirty events that satisfy the definition of "use of a hydrocarbon facility," all required measurement of the presence of the hydrocarbon itself; the tax rate was the same regardless of the complexity of the event. Further, the exemptions provided for by Senate Bill Number 1 had no relationship to the processing facility; rather, all were based upon the origin of the hydrocarbon. Finally, if the tax went unpaid, a lien attached to the hydrocarbons and not the processing facility.

B. History of Taxation on Hydrocarbons in Louisiana

1. The First Use Tax

The first effort by the Louisiana Legislature to establish a tax regime capable of ensnaring hydrocarbons flowing in commerce through the state was the "First Use Tax." The First Use Tax Act explicitly justified the tax with the state's policy to

more than 10 barrels of oil per producing day during an entire operating month.

43. Id. at § 4.1(A)(6)(iii).
44. Id. at § 4.1(A)(6)(iv).
45. Id. at § 4.1(G).
46. Id. at § 2.
conserve its natural resources— including oil and gas, water bottoms, barrier islands and coastal areas within the state. The First Use Tax Act provided:

It is one of the express purposes of this tax to require the exaction of fair and reasonable compensation to the citizens of this state for the costs incurred and paid with public funds, which costs enure solely to the benefit of the owners of natural gas produced beyond the boundaries of Louisiana, although introduced into the state, and to provide some measure of reimbursement to the citizens for damages to the state’s water bottoms, barrier reefs and sensitive shore lands as a direct consequence of activity within the state associated with such natural gas by the owners thereof.

The First Use Tax was levied at the rate of seven cents per one thousand cubic feet (“MCF”) of natural gas upon the first use of the natural gas in Louisiana. The term “use” established the scope of the taxable activity and was broadly defined as:

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.

The First Use Tax and other statutory provisions created a variety of exclusions, exemptions and credits from the imposition of the tax. For example, natural gas subject to a severance tax on the volume of production in any state or territory of the United States was excluded from the First Use Tax. In addition, any natural gas subject to a levy of any import tax or tariff by the United States as an import from a foreign country was excluded. An exemption was also allowed for natural gas used or consumed in the drilling for or production of oil, natural gas, sulfur, or in the processing of natural gas for liquid extractions in the state. Likewise, an exemption was provided for gas shrinkage volumes attributable to the extraction of ethane, propane, butanes, natural or casing head gasoline or other

49. La. R.S. 47:1301(A)(1990). Specifically delineating a state purpose in a statute is intended to justify a rational relationship between the tax and the object of the tax. See infra notes 134-35 and accompanying text. It can also be used to justify a rationale basis for treating ostensibly similar taxpayers or objects differently. See infra notes 197-201 and accompanying text.
50. Id. at § 1301(C).
51. Id. at § 1303(B).
52. Id.
53. Id. at § 1303(A).
54. Id.
55. Id.
56. Id.
liquefiable hydrocarbons.\textsuperscript{57} Natural gas that was used or consumed in the manufacture of fertilizer and anhydrous ammonia within the state was also exempted from the tax.\textsuperscript{58} A credit against any other Louisiana tax, except a severance tax, was provided to municipal and state regulated electric generating plants located in Louisiana to the extent any First Use Tax was paid by an entity on natural gas produced in the Federal Outer Continental Shelf ("OCS").\textsuperscript{59} The same credit was provided to natural gas distribution centers located in Louisiana and direct purchases of natural gas used for consumption in the state of Louisiana.\textsuperscript{60} Finally, any taxpayer subject to the First Use Tax was given a dollar-for-dollar credit against Louisiana severance tax liability.\textsuperscript{61}

The First Use Tax detailed the absorption of the tax burden. The tax was imposed on the "owner" of the natural gas and was specifically deemed a "cost associated with uses made by the owner in preparation of marketing of the natural gas."\textsuperscript{62} The statute prohibited the owner of the natural gas at the time of its imposition of the First Use Tax from claiming a right of reimbursement or refund of such taxes from any other party in interest, other than the purchaser of such natural gas.\textsuperscript{63} Any agreement to the contrary, which may have redirected the burden of the tax to anyone but a consumer, was declared against public policy and unenforceable to that extent.\textsuperscript{64}

Eight states challenged the constitutionality of the First Use Tax in the United States Supreme Court under five separate provisions of the United States Constitution.\textsuperscript{65} In \textit{Maryland v. Louisiana},\textsuperscript{66} the United States Supreme Court held that Louisiana’s First Use Tax violated the Supremacy Clause\textsuperscript{57} and the Commerce Clause.\textsuperscript{68} It declined to analyze the First Use Tax under the Import/Export Clause,\textsuperscript{69} the Impairment of Contracts Clause\textsuperscript{70} or the Equal Protection Clause.\textsuperscript{71}

The Supremacy Clause argument focused on whether the First Use Tax interfered with the federal government’s efforts under the Natural Gas Act\textsuperscript{72} to regulate the transportation and sale of natural gas in interstate commerce.\textsuperscript{73} Under then existing law, natural gas owners were entitled to recover from their customers

\textsuperscript{57} Id.
\textsuperscript{58} Id.
\textsuperscript{59} La. R.S. 47:11(B) (1979).
\textsuperscript{60} Id.
\textsuperscript{62} La. R.S. 47:1303(c) (1978).
\textsuperscript{63} Id.
\textsuperscript{64} Id.
\textsuperscript{66} Id.
\textsuperscript{67} U.S. Const. art. VI, cl. 2.
\textsuperscript{68} U.S. Const. art. I, § 8, cl. 3; 451 U.S. at 760, 101 S. Ct. at 2136.
\textsuperscript{69} U.S. Const. art. I, § 10, cl. 2.
\textsuperscript{70} U.S. Const. art. I, § 10, cl. 1.
\textsuperscript{71} U.S. Const. amend. XIV.
\textsuperscript{73} 451 U.S. 725, 746, 101 S. Ct. 2122, 2128 (1981).
all legitimate costs associated with the production, processing and transportation of natural gas.\textsuperscript{4} Unprocessed gas extracted at the wellhead includes hydrocarbons that are often owned and sold separately from the “dried” gas.\textsuperscript{75} The Federal Energy Regulatory Commission (“FERC”) normally allocates part of the processing costs between these related hydrocarbons and the unprocessed gas, insisting that the owners of the liquefiable hydrocarbons share in the expense associated with processing.\textsuperscript{76} The First Use Tax deemed the tax to be a processing cost on natural gas borne by either the pipeline or other owner without compensation—an unlikely event in light of the large sums involved—or passed on to purchasers.\textsuperscript{77} In effect, FERC argued at trial that the First Use Tax absorption rule shifted the incidence of certain expenses that were incurred substantially for the benefit of the owners of extractable hydrocarbons to the ultimate consumer of the processed gas without the prior approval of FERC.\textsuperscript{78}

The Supreme Court recognized that under the Natural Gas Act, determining pipeline and producer costs was the task of the FERC in the first instance and was subject to judicial review.\textsuperscript{79} The Supreme Court reasoned that even if FERC ultimately determined that such expense should be passed on, the decision-making authority rested with FERC. Thus, the First Use Tax statute, because of its absorption requirement, was inconsistent with the federal scheme\textsuperscript{80} and was declared invalid under the Supremacy Clause.\textsuperscript{81} The Supreme Court also evaluated the First Use Tax under the Commerce Clause. The Court noted that the flow of gas from the OCS wells through processing plants in Louisiana and through the interstate pipelines to ultimate customers in over thirty states constituted interstate commerce.\textsuperscript{82} Recognizing that a state tax is not per se invalid because it burdens interstate commerce, a state’s right to tax interstate commerce is limited. The Court stated that “no state tax may be sustained unless the tax (1) has the substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the State.”\textsuperscript{83} The Supreme Court did not address the nexus, fair apportionment, and fair relationship prongs but instead based its ruling on the discriminatory nature of the First Use Tax. The Court noted that a state tax must be assessed in light of its actual effect and that it must be considered in conjunction with other provisions of the state’s tax scheme.\textsuperscript{84} In this case, the Court was satisfied that the First Use Tax

\begin{itemize}
\item \textsuperscript{4} Id. at 748, 101 S. Ct. at 2130.
\item \textsuperscript{75} Id. at 749, 101 S. Ct. at 2130.
\item \textsuperscript{76} Id.
\item \textsuperscript{77} Id.
\item \textsuperscript{78} Id. at 750, 101 S. Ct. at 2131.
\item \textsuperscript{79} Id. at 751, 101 S. Ct. at 2131.
\item \textsuperscript{80} Id.
\item \textsuperscript{81} Id. at 747-48, 101 S. Ct. at 2129.
\item \textsuperscript{82} Id. at 754-55, 101 S. Ct. at 2133-34.
\item \textsuperscript{83} Id. at 754, 101 S. Ct. at 2133 (citing Washington Revenue Dept. v. Washington Stevedoring Ass’n, 435 U.S. 734, 750, 98 S. Ct. 1388, 1399 (1978)).
\item \textsuperscript{84} Id. at 756, 101 S. Ct. at 2134.
\end{itemize}
discriminated against interstate commerce in favor of local interest because of its various credits and exclusions. For example, Outer Continental Shelf ("OCS") gas used for certain purposes within Louisiana was exempt from the tax, but competitive users in other states were burdened with the tax for identical uses. The Court also noted that the dollar-for-dollar credit against Louisiana severance tax for anyone paying the First Use Tax on OCS gas favored those who owned OCS gas and engaged in Louisiana production. The economic effect of the credit encouraged natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than invest in further OCS development or production in other states. Finally, the Court noted that the credits provided to electric generating facilities, natural gas distribution companies and Louisiana consumers of OCS gas against other state taxes substantially protected Louisiana consumers against the impact of the First Use Tax while consumers of OCS gas moving out-of-state were burdened with the tax. The Supreme Court rejected the notion that the discriminatory activity could be justified as a proper compensating tax intended to complement the state's severance tax because any compensatory tax first requires identification of the burden for which the state attempts to compensate. Recognizing that Louisiana had an interest in protecting its natural resources and that it had imposed a severance tax on local production of natural gas as the vehicle to protect that interest, the Court noted that the First Use Tax did not achieve that end because Louisiana had "no sovereign interest in being compensated for the severance of resources from the federal owned OCS land." The Court explained that the common thread running through the cases that concerned whole and compensatory taxes was the equality of treatment between local and interstate commerce. However, the Court also noted that the paradigm of credits and exemptions allowed by the Louisiana statutes undeniably violated the principle of equality. Thus, the Court held the First Use Tax to be unconstitutional under the Commerce Clause.

2. Coastal Wetlands Environmental Levy

In the wake of Maryland v. Louisiana, Louisiana Governor David C. Treen assembled a team of tax advisors and requested that they draft a state tax statute responsive to the environmental problems plaguing Louisiana's coastal wetlands.
In the 1982 Regular Session, the Louisiana Legislature proposed House Bill 1660, known as the Coastal Wetlands Environmental Levy ("CWEL") that was designed to address the constitutional infirmities identified in *Maryland v. Louisiana*.

As with the First Use Tax, CWEL explicitly described the stated purpose of the tax. It provided:

> The purpose of this Act is to provide revenues... necessary capital improvements and public services and to ameliorate and mitigate the impact of the environmental harm to the Louisiana coastal area caused by activities associated with the transportation and development of oil and natural gas. This purpose is consistent with and supportive of the concern expressed by the federal government in the Coastal Zone Management Act.

The State of Louisiana finds that the creation and continued use of facilities associated with the transportation of oil and natural gas through Louisiana coastal wetlands caused environmental harm to the state and burdened the state with the necessity of providing capital outlays related to the improvements of the infrastructure of the state and restoration of the wetlands.

Unlike the First Use Tax, CWEL taxed oil as well as natural gas flowing in interstate commerce through the state of Louisiana. The CWEL tax was levied at a rate of six cents per MCF of natural gas and thirty-six cents per barrel of oil for the use of facilities to transport the products through the Louisiana wetlands. The term "use of facilities" was defined as the "use for more than one mile of facilities for oil and natural gas transportation through Louisiana coastal wetlands."

In order to avoid a Supremacy Clause challenge that might result from interference with the Natural Gas Act, CWEL did not specify which party would ultimately bear the burden of the tax; and it attempted to avoid conflicting with the Coastal Zone Management Act by specifically stating that its purpose was to be congruent with federal efforts. Nevertheless, CWEL faced the same obstacles as the First Use Tax did with respect to interference with the Outer Continental Shelf Lands Act ("OCSLA"). Its proponents pointed out that CWEL was not designed to allow Louisiana to capture rent that would otherwise be earned by the federal government in its capacity as owner of oil and gas reserves in the OCS.

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97. *Id.* at 173-74.
99. *Id.* at 220-21 (citing H.R. 1660, 8th Leg. Sess. § 1 (La. 1982)).
100. *Id.* at 221.
101. *Id.*
102. *Id.*
103. *Id.* at 220.
104. See *supra* note 99.
On the contrary, it was designed to offset the external social costs imposed on the state of Louisiana by such activities as oil and gas exploration and production on the OCS. In *Maryland v. Louisiana*, the Supreme Court declined to rule on whether or not the tax on the identified use of facilities in Louisiana was equivalent to a tax on the product itself. Opponents of CWEL argued that, to the extent the incidence of tax could be considered to be on the product, CWEL was in direct conflict with the OCSLA.

CWEL avoided "the complex system of exemptions and credits designed to immunize in-state concerns from the effects" of the tax which had led the U.S. Supreme Court to hold the First Use Tax unconstitutional as discriminating against interstate commerce. Opponents, however, argued that CWEL implicated the nexus and fair apportionment issues that the Supreme Court had not addressed in *Maryland v. Louisiana* when it reviewed the First Use Tax since that decision was based on a "discrimination holding."

**C. Hydrocarbon Processing Tax Compared to First Use Tax and CWEL**

The hydrocarbon processing tax did not articulate a state policy or specific purpose. It continued the trend to expand the reach of the tax to a broader range of hydrocarbon products by adding "refined products" to the list of hydrocarbons subject to tax. The hydrocarbon processing tax modeled the First Use Tax approach by virtue of the fact that the incidence of taxation was based on numerous identified triggering events. As for measurement of the tax, the hydrocarbon processing tax adopted a "volume and value" approach, similar to that of both the First Use Tax and CWEL. Akin to the First Use Tax and CWEL, the tax burden in the hydrocarbon processing tax fell on the owner of the product at the moment the taxable incident was triggered. Rather than employing exclusions, exemptions, and credits to integrate and equalize the tax burden between the Louisiana severance tax regime and the new hydrocarbon processing tax levy, Senate Bill Number 1 eliminated the severance tax on oil and gas in Louisiana altogether. The only

107. *Id.*
110. *Id.* at 220.
111. *Id.* at 236-37.
112. The call to repeal the severance tax on oil and gas extraction also addresses a Louisiana Constitutional barrier to imposition of a hydrocarbon processing tax posed by *Bel Oil Corp. v. Fontenot*, 238 La. 1002, 117 So. 2d 571 (1959). In *Bel Oil Corp.*, the Louisiana Supreme Court determined that a tax on "gas gathering" was contrary to Article VII, Section 4(B) of the Louisiana Constitution of 1921 which specifically limited taxes on natural resources to a severance tax, to wit, "[n]o further or additional tax or license shall be levied or imposed upon oil, gas or sulphur leases or right." *Id.* at 1009, 117 So. 2d at 573. The Louisiana Supreme Court held that "the levy under attack is another tax upon gas leases or rights, and as such comes squarely under the quoted prohibition. In fact, although denominated a 'gas gathering' tax, the levy covers a process which forms an integral part of severing the natural resource or reducing it to possession, and as such must be struck down . . . ." *Id.* Without its repeal provision, a similar argument could have been made that a hydrocarbon processing tax would be contrary to Louisiana Constitution of 1974, art. VII, § 4(B).
exemptions permitted by the hydrocarbon processing tax were for oil and gas produced from low yield wells, similar to the relief granted under the Louisiana severance tax regime. The only credit permitted under Senate Bill Number 1, a feature in both the First Use Tax and CWEL, was for those taxpayers who had paid a similar tax in another state before importing the product into Louisiana, provided that the other state grants a similar credit to products originally processed in Louisiana. The hydrocarbon processing tax did not direct which party ultimately would bear the burden of absorbing the tax. Finally, like the First Use Tax, the hydrocarbon tax provided an elaborate procedural mechanism to expedite anticipated litigation and sever any part declared unconstitutional.

III. CONTEMPORARY CONSTITUTIONAL ANALYSIS

A. Applicable Constitutional Doctrines

Over twenty years have passed since the United States Supreme Court analyzed the First Use Tax in Maryland v. Louisiana. At the time the Court analyzed the First Use Tax, it was applying two recently issued landmark cases involving state taxing power—Complete Auto Transit, Inc. v. Brady and Michelin Tire Corp. v. Wages. During the intervening period, the Supreme Court has confronted numerous challenges to the imposition of state taxes based on the same constitutional provisions, prompting further development of the jurisprudence in the area.

1. Due Process Clause

The Due Process Clause of the United States Constitution limits state power to impose taxes. It provides, "nor shall any State deprive any person of life, liberty or property without due process of law." In order to satisfy the Due Process Clause, a state tax must meet a minimum connection and rational relationship requirement. To satisfy the minimum connection requirement, there must be a sufficient nexus, "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Based on the principle of "fundamental fairness of governmental activity," the Due Process Clause nexus

113. See supra notes 39-44 and accompanying text.
115. See supra notes 37-38 and accompanying text.
116. See supra note 45 and accompanying text.
117. See supra note 46 and accompanying text.
120. U.S. Const. amend. XIV, § 1, cl. 3.
analysis questions whether an individual’s connections with a state are substantial enough to legitimate the state’s exercise of power over the person."

Because of the wide variety of state tax measures, the Supreme Court has articulated various forms of the nexus analysis. In general, the analyses have evolved into two levels of inquiry—presence nexus and transactional nexus. Presence nexus analysis focuses on the individual bearing the tax burden and questions whether the state even has authority to tax the taxpayer. The “presence” necessary to satisfy due process for tax purposes is equivalent to the presence necessary for a state court to exercise in personam jurisdiction over the person in a civil state court matter. If a taxpayer purposely avails itself of the benefits of an economic market in the taxing state, even if it has no physical presence in the state, such contact is sufficient to satisfy the presence requirement. The courts have also determined what type of activity constitutes “purposeful availment.” In Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County, the Supreme Court refused to recognize the exercise of personal jurisdiction over a nonresident corporation based on the defendant’s act of placing a product in the stream of commerce. The Court noted that the Due Process Clause requires the defendant’s action to be more purposely directed at the forum state than the mere placing of a product in the stream of commerce.

Once the presence nexus requirement is satisfied, the transactional nexus analysis becomes relevant. Transactional nexus analysis considers the reach of a state’s tax measure. The United States Supreme Court has stated that “[a]lthough our modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection, we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the state seeks to tax.” Thus, a state’s power to tax activities of a taxpayer is justified by the “protection, opportunities and benefits” that a state confers on those activities.

Finally, the rational relationship requirement of the Due Process Clause measures the relationship between the tax imposed by the state and the benefits that the taxpayer received from its activity in connection with the taxing state. It requires that “income attributed to the State for tax purposes must be rationally related to ‘values connected with the taxing State’.” In this sense, fundamental fairness is safeguarded.

124. Id.
127. Id.
129. Id.
130. Id. at 112, 107 S. Ct. at 1032.
132. Id.
133. Id. (citing Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444, 61 S. Ct. 246, 250 (1940)).
2. Commerce Clause

The Commerce Clause of the United States Constitution provides, "[t]he Congress shall have power . . . [t]o regulate Commerce among the several States."\(^{136}\) In addition to vesting Congress with the authority to regulate interstate commerce,\(^{137}\) the Commerce Clause has been interpreted as prohibiting states from enacting laws that discriminate against or interfere with interstate commerce.\(^{138}\) The United States Supreme Court has stated that "[t]hough phrased as a grant of regulatory power to Congress, the Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce."\(^{139}\)

a. What constitutes interstate commerce for purposes of Commerce Clause analysis?

In reconsidering the ambit of the Commerce Clause, the Supreme Court in *Commonwealth Edison Co. v. Montana*\(^{140}\) departed from the once adhered to distinction between intrastate or "local" activities and interstate activities in the context of a state's taxing power.\(^{141}\) According to this distinction, state taxes were immune from Commerce Clause scrutiny if the tax was imposed on intrastate activities only.\(^{142}\) Any direct tax on interstate activity was per se invalid.\(^{143}\) In *Commonwealth Edison*, the Court held that taxes imposed on intrastate or local activities, even prior to the entry of goods into interstate commerce, may nevertheless substantially affect interstate commerce and therefore must be examined under the negative doctrine implicit in the Commerce Clause.\(^{144}\) Accordingly, a state tax imposed on even a "local" activity will be subject to Commerce Clause scrutiny if it affects interstate commerce.\(^{145}\) Consistent with this view, the Supreme Court subjected a severance tax on coal produced in Montana to Commerce Clause scrutiny.\(^{146}\) Even though the severance tax was levied on what might be considered the "local" activity of *producing* the coal prior to its entry into interstate commerce, the severance tax was nonetheless held to affect interstate commerce.\(^{147}\)

\(^{136}\) U.S. Const. art. I, § 8, cl. 3.

\(^{137}\) Gibbons v. Ogden, 22 U.S. 1, 9 Wheat. 1 (1824).


\(^{141}\) *Id.* at 614-17, 101 S. Ct. at 2951-53.

\(^{142}\) *Id.*

\(^{143}\) *Id.*

\(^{144}\) *Id.*

\(^{145}\) *Id.*

\(^{146}\) *Id.*

\(^{147}\) *Id.*
In *Maryland v. Louisiana*, the Supreme Court noted that "the flow of gas from
the OCS wells, through processing plants in Louisiana, and through interstate
pipelines to the ultimate consumers in over 30 States constitutes interstate
commerce."\(^{148}\) The Court was satisfied that the local events identified as "uses"
in the First Use Tax did not interrupt the continual flow of gas in interstate
commerce.\(^{149}\)

**b. Analysis under the Commerce Clause**

The United States Supreme Court has often applied, and somewhat refined,
what has come to be known as "Complete Auto's four-part test" to evaluate state
taxes under the Commerce Clause.\(^{150}\) In *Quill Corp. v. South Dakota*,\(^{151}\) the
Supreme Court stated:

[W]e will sustain a tax against a Commerce Clause challenge so long as
the "tax [1] is applied to an activity with a substantial nexus with the
taxing State, [2] is fairly apportioned, [3] does not discriminate against
interstate commerce, and [4] is fairly related to the services provided by
the State."\(^{152}\)

The substantial nexus requirement of the *Complete Auto Transit* test
underwent a thorough examination in *Quill*. The Court pointed out that "[d]espite
the similarity in phrasing, the nexus requirements of the Due Process and
Commerce Clauses are not identical. The two standards are animated by different
constitutional concerns and policies."\(^{153}\) Based on the principle of "fundamental
fairness of governmental activity," Due Process nexus analysis questions whether
an individual's connections with a state are substantial enough to legitimate the
state's exercise of power over the person.\(^{154}\) The Commerce Clause substantial
nexus analysis is driven by the "structural concerns of the effects of state
regulation on the national economy."\(^{155}\) The Supreme Court explained that the
first and fourth prongs of Complete Auto's four-part test:

limit the reach of state taxing authority to ensure that the state's taxation
does not unduly burden interstate commerce . . . . Thus, the "substantial
nexus" requirement is not, like due process's "minimum contacts"
requirement, a proxy for notice, but rather a means for limiting state
burdens on interstate commerce. . . . Undue burdens on interstate
commerce may be avoided not only by a case-by-case evaluation of the

\(^{149}\) Id.
\(^{152}\) Id. at 311, 112 S. Ct. at 1912.
\(^{153}\) Id. at 312, 112 S. Ct. at 1913.
\(^{154}\) Id.; see supra notes 123-133 and accompanying text.
\(^{155}\) 504 U.S. at 312, 112 S. Ct. at 1913.
actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation.156

In the end, the Supreme Court’s focus on the substantial nexus requirement is a flexible balancing inquiry used on a case by case basis to ferret out any state tax that placed an undo burden on interstate commerce.

The second prong of Complete Auto Transit’s test requires that the state tax be fairly apportioned. “[T]he central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction.”157 The Supreme Court has stated that the fair apportionment requirement will be satisfied only if a tax is “internally” and “externally” consistent.158 A tax is internally consistent if it is structured so that if every jurisdiction applied the tax, “it would result in no more than all of the unitary business’ income being taxed.”159 The Court has also explained that, “[i]nternal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear.”160 For example, in Oklahoma Tax Commission v. Jefferson Lines, Inc., an Oklahoma sales tax on bus tickets sold in Oklahoma for interstate travel was held to be internally consistent because a ticket could only be sold in one location.161 Even if every state adopted a similar sales tax, the sale would not be subject to multiple taxation because the event, the sale, could only occur in one location; therefore it could only be taxed once.162 Thus, the Oklahoma sales tax on the gross receipts from the sale was internally consistent without dividing the tax base by applying a percentage formula.163

A state tax is externally consistent if the tax does not “reach beyond that portion of value that is fairly attributable to economic activity within the taxing State.”164 External consistency requires that the state tax only that portion of the revenues from interstate activity that “reasonably reflects the in-state component of the activity being taxed.”165 “[T]he external consistency test is essentially a

156. Id. at 312-14, 112 S. Ct. at 1913-15. In regard to use taxes, the Supreme Court held that for Commerce Clause substantial nexus purposes, a corporation must be physically present in a state for that state to impose collection responsibility upon the corporation. As a result, an out-of-state mail-order house with no physical presence in a state need not collect and pay a use tax on goods sold to customers for use in the state. Id. at 312, 112 S. Ct. at 1913.


159. Id.


161. Id.

162. Id.

163. Id.

164. Id.

practical inquiry.” In *Goldberg v. Sweet*, the Supreme Court held that an Illinois telecommunications excise tax on all interstate long distance telephone calls originating or terminating in Illinois and charged to an Illinois service address was externally consistent. In so holding, the Supreme Court noted the difficulty in administering an intangible movement and held the taxing scheme to be reasonable. Similarly, in *Oklahoma Tax Commission v. Jefferson Lines*, an Oklahoma sales tax was deemed externally consistent because it “reach[ed] only the activity taking place within the taxing State, that is, the sale of the service.”

The third requirement under the *Complete Auto Transit* test requires that a tax not discriminate against interstate commerce. A state tax that discriminates against interstate commerce will be unconstitutional unless the Supreme Court, applying its strictest scrutiny, determines that it “advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.” Even so, state laws containing discriminatory clauses against interstate commerce have been held “virtually per se invalid.” In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, a Maine statute instituted a property tax that exempted charitable and benevolent institutions. However, the exemption excluded charitable and benevolent institutions whose “operations principally benefitted nonresidents of Maine.” The Supreme Court described the statute as facially discriminatory against interstate commerce, and thus it violated the Commerce Clause. Likewise, in *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Oregon*, Oregon imposed a surcharge on the state disposal of waste generated from another state that was higher than the fee imposed on the disposal of waste generated within Oregon. The Supreme Court held the surcharge to be facially discriminatory and invalid under the Commerce Clause.

State laws that have the practical effect of discriminating against interstate commerce are also invalid under the Commerce Clause. In *West Lynn Creamery*,

166. *Id.* at 264, 109 S. Ct. at 590.
167. *Id.* at 265, 109 S. Ct. at 591.
168. *Id.* at 264, 109 S. Ct. at 590.
173. *Id.* at 568, 117 S. Ct. at 1594.
174. *Id.*
175. *Id.* at 575, 117 S. Ct. at 1598.
176. *Id.*
178. *Id.*
179. *Id.*
Inc. v. Healy, Massachusetts required milk dealers to make a premium payment for milk sold in the state. The tax was assessed on all milk regardless of whether or not it was produced in Massachusetts, but all payments received by Massachusetts were distributed to dairy farmers located in Massachusetts as a subsidy for their dairy operations. The Supreme Court struck down the statute because it discriminated against interstate commerce in favor of local interests in violation of the Commerce Clause. The practical effect of the tax was to burden exclusively out of state dairy farmers—a result achieved by the subsidy paid to in-state dairy farmers. Bearing a strong similarity to the Massachusetts tax declared unconstitutional in West Lynn Creamery, the First Use Tax discriminated against interstate commerce because of its various exemptions and credits. Therefore, it too was also held to be unconstitutional.

In General Motors Corp. v. Tracy the Supreme Court introduced a “threshold question” into the analysis of whether a tax unconstitutionally discriminates against interstate commerce. The Court held that any notion of discrimination under the Commerce Clause assumes a comparison of substantially similar entities. Specifically, the Court explained:

Conceptually, ... any notion of discrimination assumes a comparison of substantially similar entities ... When the allegedly competing entities provide different products ... there is a threshold question whether the companies are indeed similarly situated for constitutional purposes. This is so for the simple reason that the difference in products may mean that the different entities serve different markets, and would continue to do so even if the supposedly discriminatory burden were removed. If in fact that should be the case, eliminating the tax or other regulatory differential would not serve the dormant Commerce Clause’s fundamental objective of preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors. ... [I]n the absence of actual or prospective competition between the supposedly favored and disfavored entities in a single market there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply. The dormant Commerce Clause protects markets and participants in markets, not taxpayers as such.

182. Id. at 190, 114 S. Ct. at 2210.
183. Id. at 188, 114 S. Ct. at 2209.
184. Id.
185. Id.
186. Id.
188. Id. at 298, 117 S. Ct. at 824.
At issue in General Motors Corp. was an Ohio sales and use tax on the sale of natural gas by independent natural gas distributors; local public utilities however were exempt from the tax. The natural gas provided by public utilities was "bundled" with services and protections required by regulation, while the natural gas provided by independent distributors was not. Because the natural gas was bundled with services and protections, the Supreme Court believed that the products, as well as the market to which the products were sold, were distinct. Consequently, the independent distributors were found not to be similarly situated and not in competition with the public utilities. Because the Commerce Clause was designed to protect markets and the participants within them, the Commerce Clause would not apply if the discrimination did not affect economic choices. Thus, the Ohio tax did not discriminate against interstate commerce in violation of the Commerce Clause.

Even if a tax does discriminate against interstate commerce, the tax will nevertheless survive Commerce Clause scrutiny upon a showing that it is compensatory. The "compensatory tax doctrine" was developed to "make interstate commerce bear a burden already born by intrastate commerce." To take advantage of the compensatory tax doctrine, a state must first identify the intrastate burden for which the state is attempting to compensate. Next, the tax on interstate commerce must be roughly approximate to, but not exceed, the amount of tax on intrastate commerce. Finally, the events on which interstate and intrastate taxes are imposed must be "substantially equivalent."

The fourth and final requirement for a state tax to be valid under the Commerce Clause is that the tax be fairly related to the services provided by the state. In determining whether a tax is "fairly related to the services provided by the state," the relevant inquiry does not focus on "the amount of the tax or the value of the benefits allegedly bestowed as measured by the cost the State incurs on account of the taxpayer's activities." Rather, the test is whether the measure of the tax is "reasonably related to the extent of the contact, since it is the activities or presence

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190. Id. at 282, 117 S. Ct. at 816.
191. Id.
192. Id. at 297, 117 S. Ct. at 823.
193. Id.
194. Id. at 310, 117 S. Ct. at 829.
195. Id.
196. Id. at 312, 117 S. Ct. at 830.
198. Id.
200. Id.
201. Id.
of the taxpayer in the State that may properly be made to bear a 'just share of state
tax burden.' In Commonwealth Edison Co. v. Montana, the Supreme Court held
that a Montana severance tax on the severance of coal was fairly related to the
services provided by the state even though the burden of the tax was born heavily
by out of state consumers. In that case, the tax was measured by the value of the
coal severed. The Court concluded that there was a fair relation because the
operating incidence of the tax was on the mining of coal in Montana. Because
the tax was based on a percentage of the coal taken, it was in "proper proportion"
to the activities within the state.

3. Supremacy Clause

The Supremacy Clause of the United States Constitution provides that the
Constitution, Laws of The United States and Treaties "shall be the supreme Law of
the Land; and the Judges in every State shall be bound thereby, any Thing in the
Constitution or Laws of any State to the Contrary notwithstanding." Thus, if a
state tax is contrary to or conflicts in an impermissible manner with federal
legislation, it will be held invalid. While Congress can preempt state law in an area
by enacting legislation that specifically preempts state law, in the absence of
explicit congressional language, state law may nonetheless be preempted when it
is believed that Congress intended to do so. Such Congressional intent to
preempt state law can be discerned from a "scheme of federal regulation . . . so
pervasive as to make reasonable the inference that Congress left no room for the
States to supplement it," because an "Act of Congress may touch a field in which
the federal interest is so dominant that the federal system will be assumed to
preclude enforcement of state laws on the same subject." To determine whether
federal law impliedly preempts a state tax, the courts will focus on Congress'
intent.

If Congress has not completely "occupied the field" through pervasive
regulation, a state tax will be preempted "to the extent it actually conflicts with

203. Id. at 626, 101 S. Ct. at 2958.
205. Id. at 626, 101 S. Ct. at 2958.
206. Id.
207. Id.
208. Id.
209. U.S. Const. art. VI, § 1, cl. 2.
212. Id. at 204, 103 S. Ct. at 1722 (citing Fidelity Sav. & Loan Ass'n v. De la Cuesta, 458 U.S.
141, 153, 102 S. Ct. 3014, 3022 (1982); quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67
S. Ct. 1146, 1152 (1947)).
federal law." The conflict may also arise "where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'

The OCSLA explicitly provides that "state taxation laws shall not apply to the outer Continental Shelf." Nevertheless, in Shell Oil Co. v. Iowa Dep't of Revenue, the Supreme Court upheld an Iowa tax law that included revenues derived from the sale of oil and gas produced on the OCS in the apportionable tax base for purposes of calculating state taxable net income. The Court explained:

In sum, the language, background, and history of OCSLA leave no doubt that Congress was exclusively concerned with preventing the adjacent States from asserting, on the basis of territorial claims, jurisdiction to assess direct taxes on the OCS. We believe that Congress primarily intended to prohibit those direct taxes commonly imposed by States adjacent to offshore production sites: for example, severance and production taxes.

Consequently, the Court held "that the OCSLA prevent[ed] any State, adjacent or inland, from asserting extra territorial taxing jurisdiction over OCS lands but that the inclusion of income derived from the OCS in the unitary tax base ... does not amount to extraterritorial taxation by the taxing state."

In Maryland v. Louisiana, the taxpayers argued that Louisiana’s First Use Tax was a tax on the production of natural gas in the OCS and, therefore, preempted by 43 U.S.C. § 1333(a)(2)(A). While the Court declined to rule on that issue, it stated "[i]t is clear that a State has no valid interest in imposing a severance tax on federal OCS land."

4. Import-Export Clause

The Import-Export Clause of the United States Constitution mandates:

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws; and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of

216. Id. at 204, 103 S. Ct. at 1722 (quoting Hines v. Davidowitz, 312 U.S. 52, 67, 61 S. Ct. 1210, 1217 (1941)).
219. Id. at 30, 109 S. Ct. at 284.
220. Id. at 32, 109 S. Ct. at 285.
the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of Congress.\textsuperscript{223}

The contemporary analysis under the Import-Export Clause was described by the United States Supreme Court in \textit{United States v. International Business Machines Corp.}\textsuperscript{224} At issue in that case was whether a federal excise tax on insurance premiums paid to foreign insurers to cover shipments from a U.S. company to its foreign subsidiaries was a tax on the exports and therefore violated the Export Clause.\textsuperscript{225} The government argued that controlling precedent under the Export Clause\textsuperscript{226} was no longer valid in light of recent Supreme Court decisions interpreting the Import-Export Clause, specifically \textit{Michelin Tire Corp. v. Wages}\textsuperscript{227} and \textit{Department of Revenue of Washington v. Association of Washington Stevedoring Cos.}\textsuperscript{228}

In \textit{Michelin}, the Court considered whether a state could impose a nondiscriminatory ad valorem tax on imported tires that were no longer in transit.\textsuperscript{229} The Supreme Court specifically overruled \textit{Low v. Austin}\textsuperscript{230} and discredited the “original package doctrine” that had prohibited states from imposing a tax until certain goods had lost their character as “imports” and become part of the mass of property in the state.\textsuperscript{231} The Court further analyzed the words “Impost or Duties” and “decline[d] to presume it was intended to embrace taxation that does not create the evils that the Clause was specifically intended to eliminate.”\textsuperscript{232} Noting that the framers of the Constitution sought to address three main concerns by committing exclusive power to lay imposed duties on imports with the federal government, the Court explained:

\begin{quote}
[T]he federal government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the other States not situated as favorably geographically.\textsuperscript{233}
\end{quote}

\begin{itemize}
\item \textsuperscript{223} U.S. Const. art. 1, § 10, cl. 2.
\item \textsuperscript{224} 517 U.S. 843, 116 S. Ct. 1793 (1996).
\item \textsuperscript{225} \textit{Id.} at 846, 116 S. Ct. at 1796.
\item \textsuperscript{226} \textit{Id.} See also U.S. Const. art. 1, § 9, cl. 5.
\item \textsuperscript{227} 423 U.S. 276, 96 S. Ct. 535 (1976).
\item \textsuperscript{228} 435 U.S. 734, 98 S. Ct. 1388 (1978).
\item \textsuperscript{229} 423 U.S. 276, 96 S. Ct. 535 (1976).
\item \textsuperscript{230} 13 Wall 29 (1872).
\item \textsuperscript{231} 423 U.S. 276, 96 S. Ct. 535 (1976).
\item \textsuperscript{232} 423 U.S. at 293-94, 96 S. Ct. at 544.
\item \textsuperscript{233} \textit{Id.} at 285-86, 96 S. Ct. at 541.
\end{itemize}
With respect to the concern for harmony among the states, the Supreme Court stated, "[a]n evil to be prevented by the Import-Export Clause was the levying of taxes which could only be imposed because of the peculiar geographical situation of certain States that enabled them to single out goods destined for other States."\(^{234}\) Noting that the tires in question in \textit{Michelin} were no longer in transit at the time of the imposition of the tax, the Court held that a nondiscriminatory state property tax does not transgress the policy dictates of the Import-Export Clause.\(^{235}\) Further, the Court recognized that the Import-Export Clause was "not written in terms of broad prohibition of every ‘tax,’ and that imports and duty are narrower terms than tax."\(^{236}\)

In \textit{Washington Stevedoring Cos.},\(^ {237}\) the Supreme Court considered whether a nondiscriminatory state tax on the gross receipts of a company in the business of loading and unloading vessels violated the Import-Export Clause.\(^{238}\) The activity being taxed occurred while the imports and exports were in transit. The Stevedoring tax on the business of transporting cargo did not directly tax the value of the cargo as it did in \textit{Michelin}. The Supreme Court drew upon this distinction and concluded that the Stevedoring tax was not a prohibited impost or duty. Relying on \textit{Canton R. Co. v. Rogan},\(^ {239}\) which upheld a gross receipts tax on a railroad operating a dockside marine terminal transporting imports and exports, the Supreme Court held that taxation of transportation services did not relate to the value of the goods and could not be considered imposts or duties on the goods.

In \textit{International Business Machines Corp.}, the government argued that, \textit{Michelin} and \textit{Washington Stevedoring} "by analogy permit Congress to impose generally applicable, nondiscriminatory taxes that fall directly on exports in transit."\(^ {240}\) In response, the Supreme Court noted:

The Court has never upheld a state tax assessed directly on goods in import or export transit. In \textit{Michelin}, we suggested that the Import-Export Clause would invalidate application of a nondiscriminatory property tax to goods still in import or export transit. We also declined to endorse the Government's theory in \textit{Washington Stevedoring}. After reciting that the Court in \textit{Canton R. Co.} had distinguished \textit{Thames & Mersey, Fairbank,} and \textit{Richfield Oil}, we pointed out that in those cases "the State [or Federal Government] had taxed either the goods or activity so connected with the goods that the levy amounted to a tax on the goods themselves." We expressly declined to "reach the question of the applicability of the \textit{Michelin} approach when a State directly taxes imports or exports in transit," because, although the goods in that case were in transit, the tax fell on "a service distinct from the goods and their value." Thus, contrary

\(^{234}\) \textit{id.} at 290, 96 S. Ct. at 543.
\(^{235}\) \textit{id.} at 302, 96 S. Ct. at 548.
\(^{236}\) \textit{id.}
\(^{238}\) \textit{id.}
to the Government's contention, this Court's Import-Export Clause cases have not upheld the validity of generally applicable, nondiscriminatory taxes that fall on imports or exports in transit. We think those cases leave us free to follow the express textual command of the Export Clause to prohibit the application of any tax "laid on Articles exported from any State." 241

Despite the Court's tendency to abandon formalism in favor of a "principles based" inquiry, it was unwilling to set aside the "in-transit" doctrine and reserved judgment on that issue for another day.

B. Grounds for Constitutional Challenges to a Hydrocarbon Processing Tax

The hydrocarbon processing tax possessed the attributes of those state tax measures that have consistently invited federal constitutional scrutiny. The tax involved oil and natural gas in transit to the market—commodities vital to the national economic interest. Although both commodities are produced in Louisiana, for the most part, they are imported into the state and later exported after bearing the state tax. 242 The incidence of tax was defined as local events that necessarily take place in a geographical location close to the point of production or importation of the commodities. The tax was designed to fall on the owner of the commodity, who may not be a resident of the taxing state. A higher rate of tax was to be imposed on certain commodities that were imported into the state, as opposed to those originating in the state. Finally, the tax did not include an apportionment mechanism—save a credit for similar taxes paid to another state granting reciprocity. All of the above characteristics provided legitimate grounds to challenge the constitutionality of the hydrocarbon processing tax.

The two principle Due Process Clause issues presented by the hydrocarbon processing tax were: (1) the taxation of nonresident owners of the commodities and (2) the relationship between the tax extracted and the value of the benefit received from the state. Through the use of tax planning, virtually all of the oil and natural gas imported into Louisiana can be owned by nonresidents with no contact with the state other than their ownership of the commodity in transit through the state. The United States Supreme Court has held that the placement of a product in the stream of commerce by a nonresident is insufficient to grant in personam jurisdiction over the nonresident in a state court civil matter. 243 The Court has also held that the flow of natural gas from OCS wells, through processing plants in Louisiana and through interstate pipelines to ultimate consumers in over thirty states constitutes interstate

241. Id. at 862, 116 S. Ct. at 1804 (quoting Department of Revenue of Washington v. Association of Washington Stevedoring Cos., 435 U.S. 734, 756 n.21, 98 S. Ct. 1388, 1402 n.21 (1978)).

242. During the presentation to the Louisiana State Law Institute Tax Study Committee, a report prepared by the Louisiana Department of Natural Resources was circulated and estimated that in the calendar year 1998, ninety-one percent of crude oil and seventy-seven percent of natural gas processed in Louisiana were imported into Louisiana.

243. See supra notes 128-130 and accompanying text.
commerce. Would the Court find sufficient minimum contacts to satisfy the Due Process "tax nexus" when a nonresident merely places oil and natural gas into the stream of commerce when it has held that the necessary presence in a state for tax purposes is equivalent to the presence necessary for in personam jurisdiction purposes? Does a nonresident owner of the hydrocarbons have sufficient contact with the state to be subjected to the tax in conformity with due process when all he has done is place the commodity into the stream of commerce? The rational relationship requirement for Due Process Clause purposes seems closely aligned with the "fairly related to services" requirement of the Commerce Clause. However, contemporary jurisprudence addressing the Due Process analysis is not unequivocal. The abiding principle that will guide a court in this regard is the fundamental fairness of the state tax. Perhaps there is a plausible argument that the magnitude of the tax extraction is confiscatory in nature and out of proportion to any benefit conferred by the state to the owner of a hydrocarbon being processed in Louisiana.

The hydrocarbon processing tax also framed a multitude of Commerce Clause issues, one of which was the threshold question of whether the target of the tax might have been considered interstate commerce under the Commerce Clause jurisprudence. Similar to the First Use Tax, the incidence of taxation under the hydrocarbon processing tax was the first use of the hydrocarbon processing facility in Louisiana—arguably a local event. Although the incidence of taxation was defined in terms of a local event, the object of measure for the tax remained a natural resource flowing in interstate commerce. However, the fact that a tax attaches to what might be considered a local or intrastate activity does not matter for contemporary Commerce Clause analysis purposes. The Court will focus on the practical effect of the tax. Therefore, the key question is whether the hydrocarbon processing tax would have had a substantial effect on interstate commerce? The hydrocarbon processing tax would have imposed a new economic burden on hydrocarbons that are transported and sold throughout the United States. That burden would cause owners, processors and industrial end users to evaluate and react to the added cost. Even if the natural resources were produced within Louisiana and immediately trigger a taxable incidence under the hydrocarbon processing scheme, the new economic burden would have drawn Commerce Clause scrutiny.

Assuming that the subject of the hydrocarbon processing tax fell within the ambit of the Commerce Clause, the tax would have been subject to at least three distinct challenges. First, it is questionable whether nonresident owners of hydrocarbons using Louisiana facilities would be deemed to have substantial nexus with the state of Louisiana. Despite the impressive list of events that would have triggered the tax, the initial use which would have triggered it for nonresidents was the metering of their product as it entered the state. Should Louisiana be permitted

244. See supra notes 148-149 and accompanying text.
245. See supra notes 120-125 and accompanying text.
246. See supra notes 140-147 and accompanying text.
to parse into local events the commercial infrastructure necessary to bring commodities of vital national economic interest to the national market and impose a $700 million annual tax to access the local market? Would a court be persuaded that this tax amounts to prohibited state regulation of the national economy? One should also consider the imposition of a collection responsibility on nonresident purchasers of the commodity as it flows through the state. A court might have been compelled to extend the Quill "physical presence" requirement to the hydrocarbon processing tax and declare that accessing the nation’s oil and gas delivery infrastructure is truly "a discrete realm of commercial activity that is free from interstate taxation."  

Second, it is questionable whether the hydrocarbon processing tax would have been considered "fairly apportioned." The incidence of the tax was closely interwoven with the interstate movement of the taxed product. A number of the "tax triggering" events would have taken place in every jurisdiction through which the product passes on its journey to the market place. The practical effect would be a tax on the transportation or on the product itself, and each state would appear to have the same rights to tax the activity of transportation of the product or the product itself as it reached its state lines. A court should consider whether the lack of an apportionment scheme places impermissible multiple burdens on the same activity.

Finally, the hydrocarbon processing tax appeared to have a discriminatory effect on the operation of the tax on refined products. The question is whether the taxing of refined products at the rate of 1.15 times the crude oil rate would be justifiable? It is reasonable to assume that all hydrocarbons produced in Louisiana would have been subject to the processing tax before they could be converted into a refined product. Therefore, the refined products produced in Louisiana would not have borne the incremental rate, but out of state refined products entering the state would have suffered the tax. The practical effect of the higher rate on refined products, therefore, captured refined products coming from neighboring states. Refinery operations in neighboring states are substantially similar entities to refinery operations in Louisiana. Since the hydrocarbon processing tax did not contain a stated purpose for the higher rate on imported refined products, a court would have inquired as to the justification for the apparent discrimination.

The hydrocarbon processing tax also would have to overcome the Supremacy Clause hurdle presented by a potential conflict with OCSLA. The hydrocarbon processing tax would have been imposed on oil and natural gas severed from the OCS and transported into the state of Louisiana. Under the proposed legislation, the tax was to be imposed in lieu of severance taxes on certain products. If it were assumed that the hydrocarbon processing tax was a tax on the hydrocarbons produced from the OCS, arguably the tax operated as a severance tax based on its practical effect and was in violation of OCSLA’s ban on state taxation. Indeed, Bel Oil supports the conclusion that if processing is necessary to bring the natural resources produced

247. See supra notes 135-56 and accompanying text.
248. See supra note 47 and accompanying text.
249. See supra note 112.
on the OCS to the national market, the processing tax would have been equated to a production tax and would be forbidden by OCSLA.

Perhaps the most intriguing constitutional inquiry arises from the Import-Export Clause. As the United States Supreme Court reiterated in United States v. International Business Machines Corp., it has yet to "reach the question of the applicability of the Michelin approach when a state directly taxes imports or exports in transit." The hydrocarbon processing tax implicated at least two of the Michelin evils: (1) commercial relations with foreign governments and (2) a seaboard state taxing nonresident owners of commodities merely flowing through the state to other states not situated as favorably geographically. Might the hydrocarbon processing tax have presented the United States Supreme Court with the opportunity to decide the legal efficacy of the Import-Export Clause "in-transit" jurisprudence? Arguably, the tax was actually a property tax on goods still in import.

III. CONCLUSION

The proponents of the hydrocarbon processing tax have attempted to avoid the federal constitutional infirmities of the First Use Tax and to address the issues raised by CWEL. The past quarter century of decisions from the United States Supreme Court suggest a trend of expanding state power to tax commerce. Further, decisions such as Complete Auto Transit and Michelin demonstrate a shift away from rigid formalism toward a practical effect approach in analyzing whether a particular state tax violates the underlying principles of the Constitution. Nevertheless, decisions such as Quill and International Business Machines Corp. reflect the Supreme Court's reluctance to overturn bright-line tests when they support the underlying constitutional principles challenged.

If a hydrocarbon processing tax bill is ever signed into law, a constitutional challenge is certain. Despite efforts to draft the bill around the infirmities of the First Use Tax, the practical effect of a hydrocarbon processing tax remains as a state taxation of nonresidents moving a commodity of vital economic interest in commerce—a lightning rod for the convergence of constitutional concerns and policies.
