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FIRST USE TAX

EDITOR'S NOTE:

This report on Louisiana's first use tax package was compiled with the aid of Professor Emeritus Melvin G. Dakin, a constitutional law specialist at the L.S.U. Law Center.

One of the most far-reaching and controversial packages of legislation which came out of the 1978 Louisiana Legislature is the first use tax on natural gas--a package that will most assuredly wind up in a constitutional battle in the federal courts. And the stakes will be high indeed. If the first use package passes a plethora of constitutional tests, Louisiana stands to gain up to $185 million in the first year in additional tax revenues. The brunt of the burden will be borne ultimately by out-of-state consumers of natural gas produced off Louisiana's three-mile limit on the Outer Continental Shelf.

PURPOSES

Other than the obvious purpose of gaining a new and valuable source of revenue for the state, the Legislature sought through the first use tax to eliminate a long existing disparity between gas produced within Louisiana's boundary and gas produced in federal waters off Louisiana's coast. Louisiana-produced gas has been subject since 1935 to a severance tax, now seven cents per unit (1000 cu.ft.), while gas produced in federal waters outside the state's territory, sometimes in the same field as the state gas, has been subject to none. Though both types of gas ultimately come ashore in pipelines strung across Louisiana's coastline and enjoy the protection of Louisiana fire and police forces, only in-state gas has been subject to the severance tax to remunerate the state for some of the services it provides and adverse impacts caused by gas operations. Proponents of the first use tax feel the severance tax alone has failed to prevent economic waste of the state's natural resources, has unfairly burdened Louisiana producers in a discriminatory fashion and has been insufficient to correct some of the adverse environmental impacts caused by gas operations. Louisiana producers feel they are placed at a competitive disadvantage because of the severance tax: they must either increase their prices to recover the tax or absorb the tax themselves--an economically unpleasant choice in any case. One of the express purposes of the first use tax is to exact fair and reasonable compensation for the costs incurred by the state solely for the benefit of owners of natural gas produced beyond Louisiana's boundaries. Another purpose is "to provide some measure of reimbursement to the citizens for damages to the state's waterbottoms, barrier reefs, and sensitive shorelands" caused by gas operations.

HOW IT WORKS

The cornerstone of the four-bill package, and the one susceptible to the toughest constitutional challenge, is Act 294, which adds Chapter 16 to Title 47 of the Louisiana Revised Statutes of 1950. Act 294 imposes the first use tax upon "the first occurrence within this state of any use . . .of any natural gas" not subject to any other severance tax or tax upon the volume of production. The wording of the Act is extremely important because federal law prohibits the states from placing a direct severance tax upon OCS gas. The subject of the first use tax, accordingly, is not the gas itself nor the property or rights from which it is produced; rather, the tax is upon the first "use" of the gas in the state, whether the first use be a sale, a transportation in the state to a processing plant or measurement or storage facility, a transfer of possession or relinquishment of control at a delivery point in the state, a processing for the extraction of liquifiable component products or waste materials, a use in manufacturing, a treatment or any other ascertainable action at a point within the state. But while the subject matter of the tax is not the gas itself, the measure of the tax is the gas, computed at the same rate at the state severance tax--seven cents per unit.

Another provision of Act 294 declares that the first use tax "shall be deemed a cost associated with uses made by the owner in preparation of marketing of the natural gas." The purpose of this clause is to require the owner of the gas -- usually the interstate pipelines--to attempt to to pass the tax along as a cost to the ultimate out-of-state consumers. Accordingly, the Act declares invalid and unenforceable any contract by which an owner of natural gas at the time a taxable use first occurs claims a right to reimbursement from any other party in interest (i.e., the producer), other than a purchaser of the gas. If a legal action seeking to enforce such a contract is begun, the state must be joined in the action. A related section of the Act deals with the consequences that will result should the courts allow enforcement of contracts declared unenforceable by the Act. Some producer-pipeline contracts bind the producers to pay any taxes associated with the production and processing of the gas. If any such contract is upheld judicially, requiring the producer to pay the first use tax, then the tax will not be due by any party under any such contract. Most contracts between producers and processors require the producers to pay the costs associated with processing, including taxes. If any such contract is upheld--in effect prohibiting the processor from passing the tax forward to the pipeline companies--then the whole first use tax will become null and void.

EXEMPTIONS AND CREDITS

Act 294 provides that certain first uses of natural gas otherwise subject to the tax will be exempt, and another Act in the package, Act 436, allows direct tax credits in the amount of any state severance tax owed by the taxpayer. Exempted from the first use tax is gas consumed or used in drilling or production of oil, natural gas and sulphur or in processing of natural gas for extraction of liquids within the state; gas shrinkage volumes caused by extraction of liquified hydrocarbons; and gas used or consumed in the manufacture of fertilizer and anhydrous ammonia within the state.

A direct severance tax credit is allowed to taxpayers subject to the first use tax and to taxpayers who must bear the tax as a result of contractural terms or agreements applied in disregard of Act 294's "pass back" prohibitions. The amount of the credit cannot be more than the amount of state severance taxes owed by the taxpayer. No tax credit will be allowed to a taxpayer who has an enforceable right to reimbursement of the first use tax from a third party, and the credits cannot be used until a final decision upholding the first use tax has been rendered, unless the taxes are collected without either protest or suit for recovery filed directly by the person claiming the credit.

DEDICATION OF PROCEEDS

The two other Acts in the first use package, Act 293 and Act 797, deal with dedication of the tax proceeds. The two Acts are almost identical in wording and both seek to establish a First Use Tax Trust Fund for proceeds of the tax. The difference in the Acts is that one establishes the trust fund legislatively while the other proposes a constitutional amendment which the state's voters will be asked to approve, thereby ingraining the trust fund in the constitution. The ostensible purpose of having a constitutional amendment in addition to a legislative enactment is to prevent the legislature from toying with the funds in the future. If the constitutional amendment wins voter approval on November 7, 1978, only a repealing amendment will be able to change the tax dedication. Even if the amendment fails, the tax revenues will remain dedicated as set forth in Act 293 unless, and until, the legislature changes its mind.

According to Act 293 and Act 797, proceeds from the tax will be divided among three accounts--the Initial Proceeds Account, the Debt Retirement and Redemption Account, and the Barrier Islands Conservation Account.

Seventy-five percent of the proceeds will go to the first two accounts. The other twenty-five percent will go to the barrier islands account to fund capital improvement projects designed to conserve, preserve and maintain the barrier islands, reefs and shores of the state's coastline.

CONSTITUTIONAL PROBLEMS

Opponents of the first use tax claim the measure is an unconstitutional violation of the interstate commerce, impairment of obligations, due process, equal protection and supremacy clauses of the federal constitution. And, since the measure of the tax is the gas itself, opponents say the tax is a "subterfuge" for placing a federally forbidden severance tax on gas produced in the federal domain. Opponents also claim the tax is an unconstitutional levy on imports. Some of the major constitutional questions will be discussed below.

A. Commerce Clause

Recent United States Supreme Court cases have resurrected an earlier view and held that interstate commerce can indeed be required to carry its fair share of state costs associated with the commerce so long as state tax measures do not discriminate against the interstate market and so long as the measures comply with three other basic criteria:

--the tax must be related to services provided by the state.

--the tax must be fairly apportioned.

--there must be a substantial connection between the state and the interstate activity sought to be taxed.

Another factor that could be particularly significant to the first use tax is whether the taxed activity may be subject to multiple taxation by other states. The problem, then, is no longer whether the activity sought to be taxed is exclusively in interstate commerce, since the Supreme Court has expressly declared that interstate commerce can be required to carry its share of the tax burden. The problem is whether the first use tax meets the aforementioned criteria.

Opponents believe the tax discriminates against interstate commerce because gas produced within Louisiana's boundaries and gas subject to severance taxes elsewhere are exempt from the first use provisions. Supporters, however, say just the opposite effect will be achieved by the tax--the existing discrimination against gas now subject to severance taxes will be eliminated and all gas from whatever source processed in the state will be subject to a unit tax.

There appears to be little doubt that a substantial connexity exists between Louisiana and the gas activities sought to be taxed under the first use package. The gas comes ashore across Louisiana's fragile and valuable wetlands; the state's fire and police forces guard the facilities which handle the federal-domain gas as much as they guard state-produced gas; and the owners of the federal gas enjoy, among other things, the same access to Louisiana's legal system as owners of gas produced in the state. The same factors apply to the criterion requiring the tax to be related to services provided by the state.

A more substantial problem exists with the apportionment criterion, which requires that a state get only a fair return for services it provides. Opponents claim the first use tax is not apportioned at all, much less fairly apportioned. The tax is but a subterfuge for laying a direct tax on OCS gas, they say, in contravention of specific prohibitions in the Outer Continental Shelf Lands Act.

Supporters, though, believe the tax is fairly apportioned in that it is imposed upon all methane gas separated in Louisiana processing plants which has not previously been taxed, whether the ultimate destination of the gas is in Louisiana or elsewhere. The OSC Act is not violated, supporters say, because that Act does not preclude a state from taxing activities incident to products from the OCS occurring within the state's boundaries.

First use tax opponents believe that another unconstitutional aspect of the tax is that other states through which the gas passes will be able to levy a similar tax on the mineral, subjecting it to a snowball of taxes from Louisiana to Maine and increasing the price of the gas as it moves northward. But proponents argue that there can be no multiple burdens imposed on interstate commerce since the first use tax is levied on transportation and processing within the state, activities which they say cannot be repeated in any other state.

While it is true that processing of

the gas can occur only in one state, it would seem that some of the other "uses" defined in Act 294 could be repeated in other states and therefore subject to similar taxes there. For instance, gas could certainly be transported, measured and stored in another state after the same "uses" had occurred in Louisiana. But since much of the gas sought to be taxed under Act 294 is destined for processing in Louisiana (a use that cannot be repeated elsewhere), a decision declaring a tax on some of the other uses unconstitutional because of the threat of multiple taxation would, as a practical matter, be relatively insignificant.

B. Impairment of Contracts

Act 294 would clearly impair the obligation of any contract which requires a producer to bear the tax assessed in the first use package. This impairment alone, however, is not the deciding factor as to whether the obligations clause of the U.S. Constitution is violated. The U.S. Supreme Court has upheld laws impairing contract obligations if the state interests prompting the impairment were legitimate and reasonable, and if the impaired obligation was not the central undertaking of the seller nor the primary consideration for the buyer's undertaking. First use supporters say the state exercised its police power in this case to achieve an equitable distribution of the tax burden which, until now, has been borne exclusively by producers and users of Louisiana-produced gas. This equitable distribution, they say, is a legitimate and reasonable state purpose. Supporters also say the "pass-back" provisions in many producer-pipeline contracts were not the central undertakings of the sellers nor the primary considerations for the buyers' undertaking. Transfer of title with retention of the right to keep liquifiable hydrocarbons other than methane is the central undertaking in the producer-pipeline contracts, according to proponents of the tax.

C. Equal protection

Some of the exemptions provided in Act 294, like those for fertilizer and anhydrous ammonia plants in Louisiana, could raise an equal protection issue. Fertilizer and ammonia plants located outside Louisiana which use gas to fuel their facilities are similarly situated to their Louisiana counterparts, with the only apparent distinction being that some are in-state while others are not. Justifying the difference in treatment will be the state's task in the courts.

D. Supremacy Clause

Federal regulation of the interstate gas market has been expanding since the Natural Gas Act was enacted by Congress in 1938. The Federal Energy Regulatory Commission (FERC), formerly the Federal Power Commission, has dominant regulatory authority over almost all aspects of the interstate gas market. FERC, in fact, will be the agency which must initially decide whether the first use tax can be passed on as a cost to consumers. Opponents of the tax say the supremacy clause vests all control over the sale, transportation and pricing of gas exclusively in the federal government (FERC). Supporters say the clause is not violated since the FERC will have to decide whether the tax can be passed on as a cost.

RAISING THE ISSUES

Although the first use tax will not be imposed until April, 1979, two suits have already been filed--one by the state in state court seeking a declaratory judgment on the act's constitutionality and the other by FERC in federal court challenging the act. The suit by FERC may initially generate a question as to whether the regulatory body has standing to challenge the act. If standing is found to be lacking, then suit may eventually be brought by some of the states whose citizens will end up footing the tax bill.

Another recent development has been FERC's agreement to allow the pipeline companies rate relief in the event the tax is upheld. This, in effect, means the pipeline companies will be able to pass the tax along to consumers and not have to bear the burden themselves. First use proponents thought the FERC ruling would eliminate the challenge on the impairment of obligations, but FERC has specifically listed the impairments argument in its suit in federal court.

GILL NETS

Commercial gill net fishermen scored a victory recently when the Louisiana Supreme Court, in a 4-3 decision, struck down a state law which prohibited the use of gill nets in portions of Terrebonne and Lafourche Parishes. In State of Louisiana v. LaBauve, the high court declared La. R.S. 56:409 unconstitutional because its application to only two parishes violated state constitutional prohibitions against special or local criminal laws.

The gill net statute was challenged by 20-year-old Kerry LaBauve, whose father, Randolph, has long been a leader and spokesman for commercial fishermen who feel threatened by increased legislative activity in the fisheries area. The young LaBauve, in a pre-announced decision to challenge the Act, dropped his gill net in Terrebonne Parish waters while state fishery agents and reporters looked on. He was immediately arrested and later convicted after a motion to quash was overruled. The district court imposed a $400 fine (the statute allows a $200-$500 fine and a possible jail sentence of 30 days to six months), and the constitutional challenge began.

THE COURT DECISION

In striking down the statute, the state Supreme Court cited Article 3, Section 12 of the Louisiana Constitution of 1974, which provides:

> . . . the legislature shall not pass a local or special law: . . (10) defining any crime.

The factor which makes a statute local or special, said the court,

> is that it operates in one locality without the possibility of extending its coverage to other areas should the requisite criteria of its statutory classification exist there or that it affects only a certain number of persons within a class and not all persons possessing the characteristics of the class.

Admitting that the legislature can completely ban the use of gill nets statewide if it so chooses, the Court added that criminal penalties for violation may be imposed only "by a general statute applicable to all similarly-classified parishes or localities." If the court had stopped here, the broad language of its decision would have made constitutionally suspect many of the statutes in Title 56, which are limited in their application to particular parishes and localities. But the Court went further, tempering the sweeping language of the decision with a word that has become a trademark of equal protection analysis: "reasonableness." In the present context, the Court said if the operation of a law is limited to certain parishes "solely through the effect of a reasonable general classification (such as population size or physical characteristics), the law should not be considered within the prohibition" of the state constitution. The gill net statute "itself states no reasonable basis for the classification such as distinct geographic conditions which do not exist in any other part of the state," the Court added.

The fatal flaw in the gill net statute was its classification by naming parishes rather than by describing conditions. A statute which in reality would be applicable to only one parish or locality but because of its general terms could be extended to other areas if the requisite criteria exist there would not be unconstitutional under this decision. Because the reasonableness of the gill net statute "is not truly at issue," the court avoided having to deal with Article 6, Section 3 of the Constitution which allows the legislature to classify parishes and municipalities "according to population or on any other reasonable basis related to the purpose of the classification."

Although the decision is subject to more than one interpretation, the following propositions appear to be valid:

(1) Had the legislature listed in the statute the reasons it prohibited gill netting in only Terrebonne and Lafourche Parishes, and those reasons were found to be reasonable, then the statute would have withstood constitutional attack.

(2) If, hypothetically, the legislature were to prohibit fishing in certain named parishes because pollution in those parishes had contaminated the fish stocks, then the statute would be upheld, since such a classification would certainly appear reasonable.

(3) If, again hypothetically, the legislature voted to ban commercial gill netting in parishes south of the Intracoastal Waterway when biological data indicated a dangerous decrease in fish stocks, then the statute would be upheld, since by its general terms it would be applicable to any parish in the region meeting the statutory criteria.

THE DECISION'S EFFECT

The effect of the LaBauve decision on commercial gill netting in Terrebonne and Lafourche Parishes will likely be minimal because of Act 653 of 1977. That act prohibits the use of monofilament gill nets--the most efficient and widely used nets in the commercial gill netting business--in an area generally south of the Intracoastal Canal, including those portions of Terrebonne and Lafourche south of the canal. Since the prohibition of Act 653 is not limited to particular parishes, it will not likely be successfully challenged under the special and local test announced in the LaBauve case. (Act 653 is now codified as R.S. 56:322.) So while commercial fishermen can claim a victory under the LaBauve decision, the victory--as a practical matter--will not be great.

LOOKING AHEAD IN THE LCL . . .

Later issues of the Louisiana Coastal Law will delve further into legislation which emerged from the 1978 session of the Louisiana Legislature affecting coastal areas.

We will also be previewing the fisherman's gear compensation bill enacted by Congress and the attempts by parishes bordering Lakes Pontchartrain and Maurepas to draw mutually acceptable boundary lines.

Further down the road will be an in-depth view into the Shrimp Management Plan for the Gulf of Mexico--a plan still in the developmental stages but which is expected to be completed by early next year.

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