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TAXATION OF OIL AND GAS INTERESTS

Since taxation is a field governed entirely by constitutional and statutory provisions we find the same large diversity when we come to examine the taxation of oil and gas interests in the various states that we find in taxation elsewhere. In some fifteen or more states that produce petroleum at the present time there is a general lack of uniformity in tax laws and administrative methods and only a few can be said to have approved and scientific systems for the taxation of this important source of wealth. As an approach to the subject we believe it desirable at the beginning to indicate the constitutional and statutory provisions in force in the various oil and gas producing states which will indicate the nature of the taxing system used in the various states. This we propose to follow by a classification of the states that recognize the severance of the mineral estate in oil and gas from the surface estate and tax each interest to the lessee and lessor respectively, and states in which severance is not considered to result from the ordinary oil and gas lease. The property tax which is most widely applied in the states will then be taken up and its limitations pointed out. Under this head both real estate and personal property will be dealt with. Possessory rights on the public lands before and after the leasing act will be considered as well as taxation of royalty interests of the lessor. Pipe lines, storage tanks and tank cars, which are indispensable adjuncts in the handling and disposition of the products from the land, will be treated.

The gross production tax where used in lieu of the property tax and where used in connection with it will be taken up. The different rules applicable to ordinary commercial and departmental leases on Indian lands in Oklahoma will be considered as well as the application of the income taxes in states where it prevails. Inspection taxes will be treated only so far as they have arisen in judicial decisions in the oil states; and so with the gasoline taxes. Under the various methods used in the taxation of oil and gas interests the applicability and limitations of the unit and capitalization rules will be indicated together with taxpayers' remedies. Cases which are not readily susceptible of any definite grouping will be treated under a miscellaneous
heading. In conclusion we propose to summarize the advantages and disadvantages of the various taxing methods and systems in force and indicate some uniform methods that would equitably serve the interests of both the state and the lessor and lessee.

I. CONSTITUTIONAL AND STATUTORY PROVISIONS IN THE OIL STATES.

In Arkansas the constitution provides that all property subject to taxation shall be taxed according to its value equal and uniform throughout the State. The statute re-enacts that provision and provides that the situs of corporate personal property is where located regardless of location of principal office or situs of the corporation. Seiver statute will be considered later.

The California constitution requires that all property be taxed in proportion to its value. Statute re-enacts the provision with a proviso against double taxation and that all taxable property must be assessed at its full cash value. Lands and improvements thereon shall be separately assessed. A franchise tax is imposed on all corporations of 1.8 per cent annually for the exclusive benefit of the state. All franchises shall be assessed at their actual cash value. This franchise tax would include oil companies and pipe lines for the conveyance of oil. There is also in the case of oil and gas wells a provision for allowance for depletion of 27½ per cent of the gross income from the property during the taxable year. But this shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property.

Colorado constitution requires that all taxes shall be uniform upon the same class of subjects. Property shall be assessed at full cash value. Lands and improvements to be listed separately. All surface improvements and all machinery

1 Constitution, Art. XVI, Sec. 5.
2 Acts of Arkansas, 1921, Secs. 9853, 9859.
3 Art. XIII, Sec. 1.
4 Hillyer's Consolidated Supp., 1921-25, Secs. 3607, 3627. Ibid. 1927 Supp., Sec. 3726.
5 Ibid. 1927 Supp., Sec. 3664d, note 4, supra.
6 Deering Codes and Gen. Laws. Supp., 1929, Act 8488, Sec. 8, Subd. (g).
7 Art. X, Sec. 3.
located upon any mine shall be separately valued for taxation at full cash value.⁸

Under the Illinois constitution of 1870 taxes shall be laid in proportion to value of property.⁹ Statute provides that all real and personal property shall be liable to taxation. Personal property shall be valued at its fair cash sale and real property at its fair cash value at price it would bring at a fair, voluntary sale. Taxable leaseholds are valued at price they would bring at fair, voluntary sale for cash; same rule is applied to mines. Personal property shall be listed at place of owner’s residence and stocks at the principal office or place of business of the corporation.¹⁰

The Indiana constitution provides that the general assembly shall by law provide for uniform and equal rate of assessment and taxation.¹¹ Under statute all property shall be subject to taxation at its true cash value on March 1st. The rate of taxation on all property shall be equal. Pipe lines shall be taxed as property.¹²

Under the Kansas constitution the legislature shall provide for a uniform and equal rate of assessment and taxation.¹³ Statute provides that all oil and gas leases and all oil and gas wells, producing or capable of producing oil and gas in paying quantities, with all casings, tubing, and all other equipment and material used in operating the oil and gas wells, shall constitute personal property and shall be assessed and taxed as such. In valuing wells there shall, in addition to the value of all oil and gas well material, he made such valuation of oil and gas wells as would make a reasonable and fair value of the whole property. Lessor’s royalty interest in the well shall be assessed to him and the working interest (lessee’s interest) to the lessee. In determining the value of oil and gas wells the assessor shall take into consideration (a) the age of the well, (b) quality of oil produced, (c) nearness to market, (d) cost of operation, (e) permanency of market, (f) probable life of well, (g) quantity produced, (h) number of wells operated, (i) such other facts as may be known to the assessor.¹⁴

⁸Colo. Comp. Laws, 1921, Secs. 7178, 7362.
⁹Art. IX.
¹⁰Cahill Ill. Rev. Stats., 1929, Ch. 120, Secs. 1, 3, 4, 5, 7.
¹¹Art. 10.
¹²Burns Anno. Ind. Stats., 1926, Secs. 14034, 14135.
¹³Art. 11, Sec. 1.
All property, not exempted from taxation by the constitution, shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair, voluntary sale under the Kentucky constitution.\textsuperscript{15} Transporters of crude oil must report to the state tax commission the quantity transported for assessment.\textsuperscript{16} The state also has a gross production statute which will be considered later. Louisiana has a severance statute which will also be dealt with later.

The Montana constitution provides that all mines and placers shall be taxed at the price paid to the United States therefor. And that taxes shall be uniform upon the same class of subjects.\textsuperscript{17} The state has an oil producers' license tax which will be noted later.

Under the New Mexico constitution taxes levied upon tangible property shall be in proportion to the value thereof, and taxes shall be equal and uniform upon subjects of the same class.\textsuperscript{18} The statute requires every owner or operator of any oil or gas well that shall have produced oil or gas for any three months to make quarterly a verified return to the state tax commission showing the total quantity of oil and gas produced and its market value. The tax commission shall certify the net value to the county assessor after deducting 50 per cent for production cost. The assessor enters this valuation on the tax roll. The net value is obviously equal to the market value less royalties and less 50 per cent production cost. This tax shall be in lieu of all other taxes on such oil or gas wells or on their production.\textsuperscript{19}

The Ohio constitution authorizes production taxes upon oil and gas,\textsuperscript{20} but none has been enacted. The statute provides that petroleum, oil, and natural gas wells shall be assessed at true value.\textsuperscript{21}

The Oklahoma constitution provides that taxes shall be uniform upon the same class of subjects. All property which may be taxed ad valorem shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair

\begin{enumerate}
\item Sec. 172.
\item Ky. Stats., 1930, Sec. 4223c-5.
\item Art. XII, Secs. 3, 11.
\item Art. VIII, Sec. 1.
\item N. Mexico Stats., Anno., 1929, Secs. 97-401, 97-402, 97-405.
\item Art. XII, Sec. 10.
\item Ohio Stats., 1931, Sec. 5562.
\end{enumerate}
voluntary sale.22 The state has a gross production law which will be treated later.

All taxes shall be uniform upon the same class of subjects under the Pennsylvania constitution.23 By statute property shall be assessed at actual value.24 There is no special statute for the assessment of oil and gas interests aside from the general property taxes.

Under the Texas constitution taxation shall be equal and uniform. And all property shall be taxed in proportion to its value.25 All property is subject to taxation.26 The state also has a gross production tax on oil the consideration of which will be deferred.

The Utah constitution provides that all property, not exempt, shall be taxed in proportion to its value. The legislature shall provide by law a uniform and equal rate of assessment and taxation on all property according to its value in money. All mines including placers shall be taxed at the price paid to the United States therefor.27 This last provision is also found in the Montana constitution. The statute re-enacts the above constitutional provisions practically unchanged. It is also provided that the net annual proceeds of all mines and mining claims shall be taxed as personal property.28 No changes in the law have been made since 1917, from which it follows that the general property tax is applicable to oil and gas.

Under the West Virginia constitution taxation shall be equal and uniform throughout the state. And all property shall be taxed in proportion to its value.29 The statute recognizes that separate ownership of the surface distinct from the ownership of any other estate in oil and gas may be created. The assessor shall assess such respective estates to the respective owners at their true and actual value.30

The Wyoming constitution requires that all mines and mining claims from which mineral oil is or may be produced shall be taxed in addition to surface improvements, and in lieu

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22 Art. X, Secs. 5, 8.
23 Art. IX.
24 Pa. Stats., 1920, Sec. 20590.
25 Art. VIII, Sec. 1.
26 Texas Stats., 1928, Art. 7145.
27 Art. XIII, Secs. 2, 3, 4.
28 Utah Comp. Laws, 1917, Secs. 5861, 5864.
29 Art. X.
30 Barne's West Virginia Code Anno., Ch. 29, Sec. 39.
of taxes on the lands, on the gross product thereof. And except as otherwise provided in the constitution all property shall be uniformly assessed. The statute provides that the gross product of all mines and mining claims from which petroleum or other crude or mineral oil or natural gas is obtained, shall be returned for assessment for taxation and such tax shall be in addition to any tax upon the surface improvements, and in lieu of taxes upon the land of such claims while the same are being worked or operated. Verified return of the gross product must be filed with the State Board of Equalization. This board shall fix the valuation for the assessment of the gross product in gallons of petroleum, or other crude or mineral oil, or natural gas. This valuation and assessment so fixed by the board of equalization, the state auditor shall certify to the various county assessors that they may enter such valuation and assessment upon the lists of taxable property in the assessment rolls of the county. This method of returning the valuation of the gross product to the county assessors is also pursued in New Mexico. In Wyoming, however, the state board fixes the valuation while in New Mexico the market value is returned by the producer and that less 50 per cent for cost of production is returned as the net value by the state board to the county assessors.

It is thus seen that both Wyoming and New Mexico provide for a tax on the gross output of mines and oil wells at a valuation to be fixed by the state board of equalization and the state tax commission respectively and this is certified to the state auditor and by him to the county assessors, and, that this is in lieu of the land tax and of all other taxes on such oil or gas wells or on their production. The amount of the tax is not thus fixed by statute but that is determined by the local subdivisions upon the valuation found by the state board. The method is cumbersome and its only advantage is that the output is valued rather than the mine or oil well as real estate.

II. SEVERANCE OF THE ESTATES OF LESSOR AND LESSEE.

The business of oil production and development is of such nature that large capital is required. Such can ordinarily be supplied only by corporations. It is therefore impracticable for

\[^{24}\text{Art. XV, Secs. 3, 11.}\]
\[^{25}\text{Wyo. Comp. Stats., 1920, Secs. 2906, 2907, 2908, 2909.}\]
the owners of small tracts of land to undertake the production of oil and gas on their own account. Besides production there must be expensive facilities for handling the product and put it into a marketable state and bring it to the market. The result is that the small landowners lease their holdings to the oil corporations which thus acquire extensive areas from the numerous small landowners. These leases ordinarily retain one-eighth of the oil as royalty to the land owner and the balance passes to the corporation as its property.

In the taxation of these interests the problem arises who shall be taxable, the lessor or the lessee, where the oil has not already been produced. After production the oil and gas assume the form of personal property and the lessor and lessee will each be taxable for his own interest. While the product is still in the ground if the lease be treated as severing the mineral estate from the surface estate each party will be taxed for his respective interest. With difficulties that may be encountered in valuing and taxing the mineral estate, we are not now concerned.

That the ordinary oil and gas lease in whatever form creates a severance of the mineral estate from the surface estate is the doctrine adhered to by the great majority of the oil producing states. Some hold that while leases that purport to grant the oil and gas underneath the land effect a severance of the estates, a lease giving the mere right to enter and explore does not have that effect. Where no severance is created the mineral, if taxable at all, must be taxed to the owner of the land. A distinction must be taken between a mineral lease and an ordinary agricultural lease. The mineral lease always takes a part of the corpus of the land if development is undertaken, while the agricultural lease does not. For the latter the lessee is never taxable in absence of contract with the lessor.

The most outstanding support for the severance theory has come from the courts of Texas. In the first important case that arose the lessee was taxed on undeveloped leases. The court found it unnecessary to determine whether the lease conveyed any title in the lands or to the oil and gas, but sustained the tax on the ground that the rights, privileges and interests of the lessee acquired by the leases were property and subject to taxa-

There is a dissent to the effect that the leases vest in the lessee only an intangible right or privilege which is not taxable apart from the land to which it relates. This lease purported to grant the oil and gas to the lessee. On appeal the case was affirmed and it was held that the lease conveyed a defeasible title in fee to the oil and gas in the ground which was taxable as an interest in the land to the lessee. But the court states that a mere privilege to appropriate oil and gas discovered thereon is taxable against the owner of the fee and its value is to be included in the assessment of the land. In the next, and the leading Texas case, the lease granted the authority to enter and drill for oil and gas and in the event of discovery the lessee was to deliver a royalty to the lessor. The court stated that oil and gas in place are realty subject to ownership, severance and sale, while embedded beneath the earth’s surface like coal and solid minerals. “An oil lease investing the lessee with the right to remove all the oil in place . . . is, in legal effect, a sale of a portion of the land.” And since the lease might endure forever and was to terminate only upon oil or gas ceasing to be produced in paying quantities it passed to the lessee a determinable fee in the land, leaving to the grantor the possibility of reacquiring the absolute fee simple title, less whatever minerals may be in the meantime produced and marketed. The court therefore held that the lessee was separately taxable upon the value of the defeasible title in fee to the oil and gas in place, when such title has been severed, by grant, from the title to the remainder of the tract containing the oil and gas. And that even though an oil lease be construed not to pass a present title to the oil and gas in place, it may create a separately taxable estate in land. And in the federal court, following the Texas rule, it was held that an oil and gas lease giving the lessee the right to take out and remove oil and gas conveyed an interest in realty subject to the taxation under the Texas constitution.

It was stated that under the Texas law the lease is a conveyance

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34 *Texas Co. v. Daugherty*, 107 Tex. 226 (1915).
35 *Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160 (1923).
36 Note 35, supra 173. For other Texas cases recognizing the severance doctrine, see *Ferguson v. Steen*, 293 S. W. 318; *Hager v. Stokes*, 294, S. W. 335; *Stair v. Smith*, 299 S. W. 660; *State v. Downman* (Civ. App.), 134 S. W. 787; *Downman v. Texas*, 231 U. S. 353.
of the land as well as the right to use it for an indeterminable period of time. Under the Texas law, it is thus observed, the lessee is taxable on an oil and gas lease whether it is developed or undeveloped. A Massachusetts Trust was dealing in oil and gas leases in Texas. A shareholder was assessed in Arkansas on a certificate representing beneficial ownership of oil and gas leases on Texas land. It was held that the beneficial interest in the certificate was not subject to taxation in Arkansas since the equitable interest consisted of Texas real estate and for purposes of taxation a lease of land in Texas for oil and gas productions is real property whose situs for taxation is Texas and not Arkansas.38

A resident of Ohio owned a block of Kentucky oil and gas leases. It was held that an oil lease covering undeveloped territory and that has any cash value for which it could be sold at a fair voluntary sale, may be the subject of assessment and taxation. The court says that the constitutional test as to whether an oil and gas lease is taxable is—Has it a cash value in some amount? It was held also that the leases could not be assessed in a block but each must be assessed separately.39 The trial court was instructed to hear evidence and find the fair cash value of each lease, excluding the value of each producing well thereon, estimated at the price it would bring at a fair voluntary sale and then assess it. It is obvious that the Kentucky rule, following the constitutional requirement, adopted for the valuation of oil and gas leases is entirely unworkable as the basis for any property tax. It is impossible to apply the rule when the leases are assessed because they are not offered for sale. At most the court could only hear opinion evidence as to value and does not satisfy the constitutional test. When the question arose in Kentucky whether the assessment of the land included the landowner's royalty interest, it was held that the two were separately assessable.40 The statute provided that "for purposes of taxation, real estate shall include all lands and improvements thereon." The court construed this to exclude valuable mineral rights issuing therefrom which the owner has

38 Greene County v. Smith, 148 Ark. 33.
39 Raydure v. Bd. of Supervisors, 183 Ky. 84 (1919).
by lease segregated from the land. Since the land had already been assessed the court states that the royalty may be assessed as an independent item or by increasing the assessed valuation of the land to an amount equal to the value of the royalty. The case thus distinctly recognizes that the surface and mineral estates may be severed in Kentucky and when thus severed they are separately taxable.

In Oklahoma prior to the gross production tax statute the court had held that oil and gas in strata, if taxable at all prior to production, must be taxed as real property to the owner of the land, and cannot be taxed against one who has a mere lease or license to search for and take them away.\(^1\)

In a California case the lessee was assessed on "mining rights and privileges" under a lease. The lease granted the sole and exclusive right to the lessee to enter upon the land for the purpose to bore wells and extract petroleum and natural gas and convey the same therefrom. The court recognizes that strata may be divided and separately conveyed but that severance had not been affected in this instance. Here the title to the oil remained in the landowner until it was brought to the surface. But since the lessee had a leasehold estate, often commanding a large price after the discovery of oil, the lessee is separately assessable upon this leasehold value. It was accordingly held that the lessee was taxable upon the mining rights and privileges under the lease separately from the interest or estate assessed to the landowner.\(^2\)

In an Illinois case it was held that a lease which granted all the oil and gas with the exclusive right to enter for the purpose of drilling and operating for oil and gas created a "mining right," which under the statute may be conveyed by deed or lease, and that such mining right is property and should be taxed to the lessee.\(^3\) Since the lease created a freehold interest it is assessable as real property.

In a Pennsylvania case the owner sold the land and reserved all the petroleum and gas therein to himself. It was held that separate and distinct estates in unseated (uncultivated and

\(^{1}\) In re Indian Ter. Illuminating Oil Co., 43 Okla. 307, 318 (1914).
\(^{2}\) Graciosa Oil Co. v. Santa Barbara County, 155 Cal. 140.
\(^{3}\) People v. Bell, 237 Ill. 332. That an oil and gas lease creates a freehold interest in real estate in Illinois see also Transcontinental Oil Co. v. Emmerson, 298 Ill. 394.

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unoccupied) land can be created and that the several estates can be separately assessed and taxed. The former owner of the land was therefore taxable on the oil and gas he had reserved.44 This case was affirmed by the supreme court,45 holding that reservation created a severance of the oil and gas from the surface and that the separate ownership of these minerals constitutes an estate or interest in land and are separately taxable to the owner if it can be ascertained that they have any taxable value. But it added that a mere license to drill for oil and gas unaccompanied by the right of ownership in the minerals underlying the surface, does not constitute an estate in land. And where a person takes a conveyance of all the petroleum and gas contained in a tract of land, and covenants to pay all taxes assessed upon the premises thereafter, and goes into occupancy of the surface for the purpose of developing the minerals he will be liable for all taxes assessed against the premises whether for surface or for minerals.4647 The rule has also been laid down in Pennsylvania that, "Where all the coal, oil or other mineral underlying a tract of land is conveyed by deed or lease, the grantee takes an estate in land assessable and taxable to him. But if the instrument is but a lease for a definite term, with the probability or possibility of its reversion to the grantor, the estate is not assessable as land to the grantee."45†

So in Louisiana it was held that the landowner should not be taxed for a royalty interest that he had sold.46 A sale of a royalty right is a conveyance of a part of his ownership of the land. A sale of a landowner’s right to the oil and gas beneath his land is an alienation of a real right, which is classed as a servitude upon the land. It was, therefore, error for the assessor to include in the assessment to the landowner the value of the mineral rights which he had conveyed.

An Arkansas statute provided that when mineral rights in any land shall by conveyance or otherwise be held by one person and the fee be held by another, the assessor shall assess the mineral rights in the land separate from the general property therein, and a sale for non-payment of taxes of the one shall not

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45 Rockwell v. Warren County, 228 Pa. 430.
47† Moore’s Appeal, 4 Pa. Dist. Reps. 703.
48 Shaw v. Watson, 151 La. 893.
affect the title to the other. The lease involved is a grant to
the lessee for the sole and only purpose of mining and operating
for oil and gas. It was held that under this statute the lessee’s
interest in the oil and gas lease is assessable and taxable sepa-
ately from the land.\textsuperscript{47} And that under this statute an oil and
gas lease conveys an interest and easement in the land itself.

In Kansas the Statute provided that where the fee to the
surface of land is in one person and the right or title to min-
erals in another, the right to such minerals shall be valued and
listed separately from the fee of the land. The court states that
this statute authorizes severance of estates and whether a seve-
rance has been affected depends upon the nature of the lease
whether it confers a mere license or grants an estate in the
mineral. The lease in question grants, conveys and warrants all
the oil and gas in and under the land, together with the right
to enter for the purpose of operating for oil and gas. It was
held that this lease affected a severance under the statute and
was taxable to the lessee.\textsuperscript{48} In an earlier case the court had
arrived at a contrary conclusion. The lessor had leased to the
lessee the exclusive right for ten years “to enter upon, operate
for and procure oil and gas.” The court said that the lease
granted no estate in the oil and gas but that it was only a license
to enter and explore for oil and gas, and to produce and sever
the same if they should be found. No severance of title occurs
under such a lease until the oil is brought to the surface. Until
then they remain a part of the land and, therefore, it is not
taxable to the lessee until produced. A distinction is taken
between a license to enter and mine, which the lease in question
is, and the grant of an estate in the minerals themselves. In
the latter case they are separately taxable, in the former they
are not.\textsuperscript{49}

In New York a statute provided that oil wells and all fix-
tures connected therewith, situated on lands leased for oil pur-
poses and oil interests, and rights held by virtue of any lease
or license to operate and produce oil, shall be deemed personal
property for all purposes except taxation. The court holds

\textsuperscript{47} State v. Arkansas Fuel Oil Co. (Ark), 18 S. W. (2d) 906. That
a sale of the land with a reservation of the oil and gas to the grantor
creates a severance of the estates, see Bodcaw Lumber Co. v. Goode,
160 Ark. 48.

\textsuperscript{48} Mound City Gas Co. v. Goodspeed Gas & Oil Co., 53 Kan. 136.

\textsuperscript{49} Kansas Natural Gas Co. v. Neosho County, 75 Kan. 335.
that oil wells must be assessed as real property under this statute.\textsuperscript{50}

We have already seen that Oklahoma has declined to recognize the severance theory and refused to tax oil leases to the lessee. In that case the court said: "To undertake to tax an oil gas lease is to undertake to impose a tax upon the illimitable vista of hope. . . . Whether oil is under any particular tract of land is beyond the ken of man until a well has been drilled, and even then no one can foresee how long the well will last, or what its production will be."\textsuperscript{51}

The question of severance between the mineral estate of oil and gas and the surface estate in the land does not seem to have been considered by the highest court in Ohio. We have found only one decision in the inferior courts. In a nisi prius case the court considered the statute of 1859 which provides that "where the fee of the soil of any tract . . . is in any person . . . and the right to any minerals therein in another, the same shall be listed to such ownership in separate entries, and taxed to the parties owning the same." The lease granted the exclusive right for "the purpose of operating and drilling for petroleum and gas." It was held that the lease operated to convey the oil found in place, and is subject to taxation separate from the fee of the soil.\textsuperscript{52} The case was, however, reversed in the circuit court which held that the statute applied only to land and that the oil lease involved was not a bargain and sale of the minerals, and did not convey the same in fee to the lessee, but was a license, or lease at will. It was, therefore, not taxable to the lessee.\textsuperscript{53} From which it appears that Ohio does not recognize the severance doctrine.

Although the West Virginia statutes recognize the creation of separate estates in minerals and surface of the land,\textsuperscript{54} the decisions have not always been consistent in the application of the doctrine. In one of the earlier cases it was stated that oil in cavities of rocks is real estate and does not become personal property until brought to the surface, and that the oil in place did not belong to the leasee and was not assessable to him, but

\textsuperscript{50}In re Hazelwood Oil Co., 185 N. Y. S. 809.
\textsuperscript{51}Note 41, supra.
\textsuperscript{52}Jones v. Wood, 1 Oh. N. P. 155, 2 Oh. Dec. 75 (1894).
\textsuperscript{53}Jones v. Wood, 9 Oh. Cir. Ct. 590.
\textsuperscript{54}Note 30, supra.
the owner of the freehold is taxable for the oil.\textsuperscript{55} The oil wells on the land were therefore not taxable to the lessee, except the equipment. The prospective production of oil from the wells cannot be assessed to the lessee as personal property. The same doctrine is announced in a later case that oil in place is realty, and becomes personalty only when brought to the surface. A lessee under an ordinary oil lease for years has no vested taxable estate in the oil still in the ground, either before or after he has found paying wells. It is taxable in the name of the surface owner.\textsuperscript{56} In the first West Virginia case where the question arose the court held that there may be separate ownership of the surface and the minerals underneath and that where one party owns the surface and another the underlying minerals the taxes may be assessed on the interests in the land to the respective owners.\textsuperscript{57} The case does not show whether solid minerals or oil and gas were involved, but probably the former.

The leading West Virginia case involved the taxation of certain oil leases to the lessee. The lease granted the exclusive right to produce petroleum for ten years or as long as oil and gas may be found in paying quantities. The court holds that such a privilege, liberty or license to search for oil and gas coupled with a grant to remove them becomes a freehold interest upon discovery of oil in paying quantities and is assessable as a separate estate to the lessee. But if the lease is limited for a definite term of years no freehold ownership is created and the interest should not be taxable to the lessee but to the landowner. Only when a freehold interest has been created in the oil and gas are they separately assessable to the lessee. And an ordinary oil and gas lease does not create a freehold interest until the oil and gas is discovered in paying quantities.\textsuperscript{58} Again the West Virginia court has held that an undivided estate in oil and gas is not separately assessable from the surface of the land, but all is assessed to the land as a whole and as an entirety.\textsuperscript{59} And where the lease granted a defeasible title in fee to the oil and gas which under the statute should have been assessed to the grantee, but was not, the payment of

\begin{itemize}
\item \textsuperscript{55}Carter v. Tyler County Court, 45 W. Va. 806.
\item \textsuperscript{56}Peterson v. Hall, 57 W. Virginia 535.
\item \textsuperscript{57}Low v. County Court, 27 W. Virginia 785.
\item \textsuperscript{58}State v. So. Penn Oil Co., 42 W. Virginia 80.
\item \textsuperscript{59}State v. Guffey, 82 W. Va. 462.
\end{itemize}
taxes by the grantor, after the conveyance, on the whole was sufficient to prevent a forfeiture of the interest conveyed. And it has been held that oil and gas interests may be assessed separately from the surface and return delinquent and sold for non-payment of taxes. It is obvious that under the South Penn Oil Company decision lessees may hold large undeveloped tracts of oil and gas lands in West Virginia and not be subject to taxation until oil is discovered in paying quantities when the estate will be enlarged into a freehold and then first taxable to the lessee.

Where grantors in West Virginia conveyed to the grantee an undivided one-sixteenth part of the oil and gas the grantee of such undivided interest did not hold by a complete and separate title and his interest was not subject to separate assessment for taxes. The assessor purported to assess the grantor for only fifteen-sixteenths and the grantee for his interest. But it was held that the assessment to the grantor must be presumed to include the whole and that the West Virginia statute providing separate assessment where the interests are divided among several owners had no application here. This case was affirmed by the Circuit Court of Appeals.

In Indiana an oil and gas lease granting to the lessee the oil in the land with the right to enter for the purpose of drilling ripened into a conveyance of an interest in the land when the wells were located, and the wells with the pipes, casing, tubing, rods, and other machinery and equipment connected with the wells became realty, and therefore a sale thereof for delinquent taxes as personal property was void.

From the foregoing cases it appears that all the state producing oil and gas, except Oklahoma and Ohio, recognize that there may be a severance of the surface and mineral estates created by oil and gas leases for the purpose of taxation. And in Oklahoma the property tax has been superseded by a tax on the gross output so the question is of no further importance there. Solid minerals have always been considered susceptible of separate conveyance. But with respect to oil and gas, because

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*Barnes v. Bee, 138 F. 476.
*Bee v. Barnes, 149 F. 727.
of their fugacious character, it has been much debated whether even the landowner can be said to own the oil and gas beneath his land before they are reduced to possession. Certainly all courts agree that if oil and gas under A's land find its way into B's land and is there brought to the surface they are no longer A's property but have passed into the ownership of B. As to whether or not a particular lease affects a severance of the estates the language used in the instrument is largely determinative. Thus a lease which purports to grant and convey the oil and gas are in all those states treated as affecting a severance, while a lease that merely purports to confer a right, privilege or license to enter and explore and to remove the oil and gas if found are considered as not effecting a severance of the estates. This is especially the view taken in Kansas. The West Virginia cases have held both ways, depending upon the facts, but in view of the South Penn Oil Company case undeveloped oil leases must be treated as not taxable to the lessee.

III. Property Tax Applied in Most States.

When it has been determined what parties are legally taxable with the various interests created by oil and gas leases, the problem arises as to what means are to be pursued in fixing the amount of the taxes which are to be levied. Here we find that the ordinary property taxes are used in practically all of the states. In a few the property tax is supplemented by a tax measured by amount or value of the product. Rarely do we find a tax on production used exclusively. Recognizing the insurmountable difficulties in the way of attempting to value oil and gas in the ground, some state tax administrations have attempted to turn the property tax into a production tax by roughly measuring the value of the output rather than the value of the lease itself. The equipment used in oil production is taxable as personal property at some valuation that the assessor may be able to determine.

Thus while Kentucky has a tax on the gross product which shall be "in lieu of all other taxes on wells producing crude petroleum," the court held that this tax was not intended to include the value of oil and gas leases, and that the production tax on the oil produced is separate and distinct from the ad valorem tax to which the leases are subject and cannot operate
to exempt them from the property tax. The value of the leases were to be fixed under the constitution at a fair cash value that they would bring at a fair, voluntary sale. Obviously this can be no more than matter of opinion as leases are rarely sold. In this case the assessor in interpreting the above "in lieu" clause exempted five acres surrounding each well and assessed the rest of the leases to the lessee in an aggregate sum. It was held that each lease should have been assessed separately and that the method of assessment should be to find the fair cash value of each lease, excluding the value of producing wells therefrom estimated at the price it would bring at a fair, voluntary sale.

The rule laid down by the constitution is absolutely unworkable in absence of sale to determine the fair cash value of the particular tract involved. And then, who shall say that the cash value is fair? The constitutional rule was laid down in Kentucky before any oil was known to exist there and is utterly inapplicable as a rule for the valuation of oil and gas leases. Since sales are unlikely to occur the court is compelled to rely solely upon opinion evidence.

We have seen that Oklahoma refused to tax oil and gas in the ground to the lessee on the ground that it was impossible to determine its extent or value. And that, if they were taxable at all, they must be taxed to the land owner as a part of the land. In California where, aside from the corporate franchise tax, we have only the property tax applicable to oil and gas interests the assessors have attempted to arrive at a valuation by using production as a basis. The method consisted of taking the total production for the preceding year on the tract in question and fixing the value at one dollar per barrel for the oil. Sixty-five cents per barrel was allowed as production cost. The remainder, times the total quantity, gave the total net income of the oil. For the gas 25 per cent was allowed for production cost. The total net income of oil and gas was then capitalized at 10 per cent. Forty per cent of this capitalized value was the value taken for taxation. $100 was added for the surface value of the 20 acres of ground and the nine or ten oil wells on the tract were valued at approximately $40,000. This

64 Raydure v. Bd. of Supervisors, 183 Ky. 84 (1919).
65 Note 41, supra.
method of assessment of the lessee's interest was sustained. While this method is to be preferred to any attempt to place a fixed value on the lease the method is awkward. And capitalizing the net income may result in an excessive valuation very often. A production tax instead in lieu of all other taxes would simplify matters greatly and would be just to both the producer and the state.

We have seen that under the Kansas Statute all oil and gas leases, wells and equipment are declared to be personal property for the purpose of assessment. Royalty interests shall be assessed to the owner and working interests to the lessee. Where the lessee assigns a part or the whole of the lease and reserves a royalty in addition to the royalty already reserved by the land owner this share reserved by the lessee is designated as "overriding royalty." Such overriding royalty is taxable to its owner, the lessee. The Kansas statute previously noticed has been found unworkable in practice in attempting to apply the formula laid down for the guidance of assessors. Leases are attempted to be assessed on a gross production basis although no gross production law exists in the state. Undeveloped leases are not assessed. On developed leases the valuation is based upon so much per barrel of daily production, usually about $1,000 per barrel per day on the average daily production of the previous year. The value per barrel is based on the market price of fresh crude oil on tax day. In some cases the assessment of the lease is based on the estimated underground reserve—the method contemplated by the statute. Only equipment and leaseholds are assessed. The legal machinery for the assessment of oil and gas leases in Kansas is inadequate and extra-legal methods are developed and resorted to to determine valuations as a basis for taxation. A law authorizing a tax measured by production is needed.

In Texas property must be valued as of tax day, January 1st, for the year following. The owner of land had been taxed

**Note 14, supra.
***Thuss, Texas Oil and Gas, p. 223.
*****Note 14, supra.
for the land as of that date. Shortly after he leased the land and the big discovery in the Powell oil field resulted. It was attempted to assess the lessee for a large sum but the court held that it was not taxable for that year. The land had not been leased on tax day and there had been no severance of estates taxable to the lessee. The rendition of the land by the owner carried with it the value of the entire estate. Here a property tax allows the lessee to escape taxation for practically a year. Under a gross production tax the lessee would have been taxable from the moment that the wells commenced to produce. The state has a gross receipts tax intended to supplement the property tax, but that is inadequate when the property tax fails. Then if a property tax is based on the amount of production for the preceding year the lease is likely to be greatly over assessed since wells usually fall rapidly in production. For the year following tax day the production is likely to be much less than it was for the preceding year upon which valuation of the product is based. Here the gross production tax again is just since that taxes only the amount produced and automatically adjusts itself to a declining as well as to an increasing production. While oil and gas leaseholds are taxable, as a matter of practice, many counties refuse to tax non-producing leases to encourage leasing. Producing leases are assessed at a value per barrel on the average daily settled production. The equipment is assessed as personal property. The state board has nothing to do with assessments. This duty is performed by the assessors and local boards only. Likewise in Louisiana before the present severance tax the valuation of oil leases was determined on a production basis at so much per barrel upon the total quantity of barrels produced.

(a) Possessory Rights.

The taxation of possessory rights has arisen in connection with the occupation and the production of oil and gas upon the public lands in the west. Prior to the Leasing Act of 1920 oil and gas claims were located upon the public domain under the Placer Act of 1870. The claims were not taxable as land before patent. Certain placer mining claims had been located

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72 Humble Oil & Refining Co. v. State (Tex.), 3 S. W. (2d) 559.
73 Note 71, supra.
74 Palmer Co. v. Police Jury, 142 La. 1076.
on the public domain in California and transferred to an oil company that entered into possession and occupation. These possessory rights in the placer claims were assessed and held taxable. It does not appear that any equipment was involved in this case. The court stated that the possessory right to a mining claim is property, and as such may be sold, transferred, or levied upon, and is subject to taxes like other property.\(^7\) It is not clear, however, how the rights may be levied upon and sold for taxes since the land is still a part of the public domain. But the company having paid the taxes under protest was denied right to recover them back. A California statute provides that the assessor must collect taxes on all property where they are not a lien upon real property sufficient to secure the payment of them. It was held that this section permits assessment and collection of taxes upon possessory rights in taxable improvements upon lands which are themselves exempt.\(^6\) Since these possessory rights have no security or lien to support the tax there is reason for classifying them with personal property and apply the remedy of distress.

In Montana the question arose whether the assignee of oil and gas leases held from the United States was subject to the annual license tax of the state upon the gross value of the oil produced. Exemption was sought on the ground that these leases were agencies and instrumentalities of the United States used in the development of the natural resources in the public domain. The tax was upheld on the ground that the immunity from state taxation extends only to those agencies of a strictly governmental character as distinguished from those doing business of a private character.\(^7\) Furthermore, this question is now covered by the proviso in Sec. 32 of the leasing act. It states that "nothing in this act shall be construed or held to affect the rights of the States or other local authority to exercise any rights which they may have, including the right to levy and collect taxes upon improvements, output of mines, or other rights, property, or assets of any lessee of the United States.\(^7\) This case was affirmed on the authority of the leasing act. The court stated that even assuming that a lessee

\(^{15}\) Bakersfield & Fresno Oil Co. v. Kern County, 144 Cal. 148.
\(^{16}\) Mohawk Oil Co. v. Hopkins, 196 Cal. 148.
\(^{17}\) Mid-Northern Oil Co. v. Walker, 65 Mont. 414 (1922).
\(^{18}\) 41 Stat. 437, Sec. 32.
engaged in producing oil on the public lands is a governmental agency or instrumentality and that the Montana tax could not be levied without the consent of Congress, yet that consent was given by Section 32 of the Leasing Act in the proviso. It thus appears that lessees of oil and gas interests upon the public domain are subject to all state taxes the same as upon leases held under private ownership, except that the leasehold would not be taxable as land. But all equipment used in the production of oil and the production itself may be taxed.

(b) Royalty Interests.

As we have seen the nature of the business of oil and gas production and the marketing of the product demand large capital and resources which can only be supplied by large corporations. That fact has been responsible for the whole development of the leasing system and of the law of oil and gas. When the small landowner leases a tract of land for the development of oil and gas he agrees that if oil and gas are found to surrender a part of the corpus of his land. In return therefore he retains a small portion of the oil and gas in case that the development should result in production, which portion is termed the landowner's royalty interest. This ordinarily consists of one-eighth of the oil saved which is delivered to him free of expense or at his option paid for at the market price. The royalties on gas wells usually take the form of a cash sum ranging from one hundred to one hundred fifty dollars or more for each well per year. The lessee assumes all risks of failure of the enterprise, dry holes, and other unavoidable risks and takes the rest of the product as long as the wells continue to produce in commercial quantities. The lessee's interest is termed the working interest. Each party is ordinarily taxed on his own interest but the lessee alone pays the severance tax where that is imposed. The landowner in addition to the taxes on his surface estate is taxed for his royalty interest.

We have already seen that in Kentucky the royalty interest is separately taxable to the landowner although his land has been previously assessed and that the taxation of the land did not include the taxation of the royalty interest. And the lessee is taxable on his seven-eighths interest after deducting

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79 Mid-Northern Oil Co. v. Montana, 268 U. S. 45.
the lessor's reserved royalty interest. In Louisiana it is held that the landowner is not liable for the license tax on his royalty share reserved in an oil and gas lease. Act 209, 1912, levied an annual license tax upon all persons engaged in severing natural products, including oil and gas, from the soil. This did not levy a license tax upon a landowner who is not engaged in the business of severing the natural products from the soil but has leased his land and reserved a royalty. The severance tax is payable by the lessee only on the entire product taken from the ground. If the lessee desires to avoid the severance tax on the royalty interest he must do so by contract. Nor does article 229 of the constitution authorize the levying of such license tax upon the landowner or royalty owner who is not engaged in the business of severing the natural resources from the soil. And in the same state it has been held that the valuation of a tract of oil-producing land for taxes assessed against the owner should not include the value of mineral rights or royalties which the landowner has sold before the beginning of the calendar year for which taxes were assessed. To the extent to which the landowner has alienated his royalty interest or mineral rights they should not be assessed against him, nor should their value be added to the assessment of the land for taxes.

In Texas the landowner owned royalty interests which gave substantial production. The quantity produced on January 1st was assessed at $1,000 for each barrel produced while the lessee was assessed $450 per barrel of production on his working interest. It was contended that the assessment of the royalty interest was excessive and discriminatory but the tax was upheld. The lessee assumed all the risk of the business and the drilling of dry holes while the lessor was put to no expense or risk with respect to the royalty share that was required to be delivered to him. Hence there was justification for the classification and the valuing of the royalty at a much higher figure per barrel than that assigned to the working interest of the lessee. This case was affirmed in the higher courts. In a

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82 State v. Stiles, 137 La. 540.
83 Shaw v. Watson, 151 La. 893 (1922).
84 Waggoner v. Wichita County, 298 F. 818.
85 Same case, 3 F. (2d) 962 and 273 U. S. 113.
suit to restrain the collection of a tax on certain oil royalties it was contended that by the lease all of the oil and gas under the land became the property of the lessee and should have been assessed to him and that no part was assessable to the lessor. The lessor still retained one-sixteenth royalty interest and this was assessed to him. Under the statute real property for purposes of taxation shall include the land and all the minerals therein. It was held that the royalty interest was not the property of the lessee. The effect of the lease was to sever the minerals from the rest of the land and to vest in the lessee seven-eighths of the oil and the ownership of the royalty interest remained in the lessor and since this was not listed for taxation the board of equalization could add it to the land. And where the lessor executed oil leases reserving one-sixth and one-eighth of the oil as royalty it was held that the title to the fractions not conveyed remained in the lessor as real property and was subject to taxation to the lessor while the lessee’s share was taxable to him as real property. The same was held in other Texas cases.

So in Kansas royalty interests are assessed to the landowner and working interests to the lease owner. And overriding royalties are assessed to the assignor who reserves them. A Montana lease granted to the lessee all the oil and gas under the land; the lessee agreeing to yield and pay to the lessor one-eighth part of all the oil. It was held that in this lease complete title to all oil recovered vested in the lessee and only subjected the lessee to deliver one-eighth. Hence the royalty oil recovered was the property of the lessee and properly assessable and taxable to him. In the second lease involved certain parties were declared to have, own and hold an interest in the oil under the land in the proportion set opposite their names, and were the royalty holders and owners of the royalties of the oil. And the lessee agreed to deliver and credit the royalty holders with 15 per cent of all the oil produced and saved. In the third lease the lessors reserved one-eighth of all the oil produced and saved from the lands. It was held that in leases two

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8 Ferguson v. Steen (Tex.), 293 S. W. 318.
9 Hager v. Stokes (Tex.), 294 S. W. 535.
10 Stair v. Smith, (Tex.), 299 S. W. 660; Cobb v. Downing (Tex.), 1 S. W. (2d) 508.
and three the royalty holders were themselves taxable on their royalty interests. Obviously there is a difference in the legal effect of these leases. In the first the whole title to the oil and gas passed to the lessee and he agreed to surrender the royalty portion, while in the second and third the title always remained in the landowners to the royalty oil. Each were taxable on the royalty interest to which they held title. A Montana statute, 1927, requires the operators of mines and oil and gas wells to withhold from the royalty interest the amount of net proceeds tax due from the royalty owners. The statute has been upheld. Owners of royalty interests in oil wells are thus taxable on the net proceeds yielded to them. Likewise where a prospector entered upon land under an operating agreement with the lessee, whereby the prospector was to receive 75 per cent of all oil and gas obtained from the land from drilling and operating oil wells and the lessee and owner equally divided the balance, the prospector is owner of his proportion of the oil and gas produced and taxable for that amount only under the net proceeds tax.

(c) *Pipe Lines.*

As petroleum and natural gas come from the wells they are collected in gathering pipe lines in the field which unite to form trunk lines. The large quantities of crude oil are by this means transported to the refineries. For the transportation and distribution of the finished product resort must be had to tank cars. The pipe lines are of immense extent. Oil from the Texas, Oklahoma and Wyoming oil fields which are not refined at local refineries may be sent through a system of pipe lines to the Atlantic seaboard. For the purposes of taxation pipe lines are regarded as real estate and subject to local taxation like land. Thus a pipe line from Pennsylvania to New Jersey for conveying crude oil was subject to local township taxes in New Jersey. It was held that the pipe line was real estate and subject to local taxation. So an annual license tax against a corporation, consisting of a certain per cent of the gross receipts from the transportation of oil through its pipe lines

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80 *Homestake Exploration Corp. v. Schoregge*, 81 Mont. 604 (1928).
81 *Byrne v. Fulton Oil Co.* (Mont.), 278 Pac. 514.
82 *Fulton Oil Co. v. Tooke County* (Mont.), 283 Pac. 769.
83 *Tidewater Pipe Line Co. v. Berry*, 52 N. J. L. 368 (1890), 53 N. J. L. 212.
during the year preceding the levy, the gross amount being such proportion of its gross receipts for transportation of oil over its whole line as the length of its line in the state bears to the length of its whole line, is valid and not a burden on interstate commerce. A pipe line although engaged wholly in transportation of oil in interstate commerce is subject to a special assessment tax levied on it as real estate for preliminary expense of a drainage and highway district. This tax is sustained on the ground of special benefits conferred. An occupation tax of two per cent on the gross receipts derived from transporting oil through a pipe line, wholly within the state, but which receipts are derived from both intra and interstate commerce is invalid as to receipts derived from interstate commerce. Since the statute provides for no way to separate the receipts and the intent was to levy a tax on the business of both intra and interstate commerce the whole statute was void. The tax was levied on the total gross receipts if the line was wholly within the state which was this case. If the line was partly within and partly without the state the tax was levied on such proportion of the gross receipts, as the length of the line within the state bore to the whole length of the line. This latter provision with respect to an interstate line would seem to be valid. A pipe line company may in the first instance be required to pay a tax levied on producers where rights of reimbursement against the producers are given by the statute.

Under the federal income tax law the owner of a pipe line who transports his own oil is required to pay the same tax as if he were transporting oil for hire. Thus under the War Revenue Act of 1917, section 501, it is provided that "in case any carrier does not, because of its ownership of the commodity transported, or for any other reason, receive the amount which as a carrier it would otherwise charge, such carrier shall pay a tax equivalent to the tax which would be imposed upon the transportation of such commodity if the carrier received payment for such transportation." It was held that the act was

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95 State v. Humble Pipe Line Co., 112 Tex. 375.
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constitutional and that a pipe line company which transports its own oil must pay a tax equivalent to that imposed on companies transporting oil for hire. The tax under that act was five per cent of the amount paid for transportation of oil to the pipe line if for hire. The act of 1918, section 500(e), increased the tax to eight per cent of the amount paid for the transportation of oil by pipe line. Section 501(d) provided that the tax imposed shall apply to all transportation of oil by pipe line. And that if no charge is made by reason of ownership, the transporters by pipe line shall pay a tax equivalent to the tax which would be imposed if such person received payment for such transportation. The tax it was stated is levied upon the privilege of transportation; on the right to employ pipe line facilities. A corporation operating petroleum refineries in Kansas, which obtained its crude oil from its own and other wells through its own pipe lines, was held subject to tax on transportation by pipe line under the Act of 1918. It was stated that the act was not limited to common carriers. The tax was an excise on the use of property and did not require apportionment but was only subject to the rule of uniformity. And an oil producer that transported oil through its own pipe line from its field for 8000 feet to the railroad, from which point it was shipped by rail, was held subject to tax on such transportation under the Act of 1918. It was undoubtedly the purpose of Congress to prevent those who own their own pipe lines from getting an undue advantage over producers who do not own pipe lines. The commodity clause in the Hepburn Act of 1906 forbidding railroads to ship their own property is analogous. The court in this case said: "If the producer, who is fortunate enough to own these facilities for the handling of his own oil, is not liable for the tax, then he enjoys just that much advantage over the one who does not, and discrimination becomes apparent." This case was affirmed by the Circuit Court of Appeals.

There are no cases disputing the fact that states may tax the physical property of pipe lines, storage tanks and pumping

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97 Meischke-Smith v. Wardell, 286 F. 785.
100 Dixie Oil Co. v. U. S., 24 F. (2d) 304.
stations connected with the pipe lines under their property taxes. These articles have a local situs. But when it is attempted to tax the oil in constant motion through these pipes when the state lines are crossed difficult problems arise which have not so far been solved. Thus in the case of a pipe line extending from Kansas to Indiana and always full of oil, a certain county in Illinois sought to tax the oil in the pipe under the general property tax. It was held that the oil was not taxable. This oil while on its way from one state to a point in another state, is a subject of interstate commerce and is therefore exempt from local taxation.\textsuperscript{101} The oil never acquired a situs in Illinois so that it can be said that it became a part of the personal property of the districts through which it passed. A like conclusion was reached by the West Virginia court. There oil purchased at producers' stock tanks in the state by a pipe line company and in transit through its pipe line system to purchasers in another state, was held to be in interstate commerce and therefore not legally subject to personal property taxes in West Virginia. And that was true, although as incidental to such commerce, quantities of the oil accumulated temporarily in collecting tanks which are a part of the pipe line system.\textsuperscript{102}

In the only two cases that seem to have arisen the right to tax oil moving in interstate commerce has been denied. In justice the states that are protecting the oil in transit as well as the physical line should be able to exact compensation in the form of a tax. In the \textit{Pullman's Palace Car Co.} case the company's cars continually moving through the state of Pennsylvania were held taxable under a proportion rule. There was taken as the basis of assessment "such proportion of the capital stock of the company as the number of miles over which it ran cars within the state bore to the whole number of miles in that and other states over which its cars were run."\textsuperscript{103} This case is distinguishable as a tax on the vehicles employed in interstate commerce rather than a tax on the property itself transported in commerce. It seems that some rule based on the theory of the \textit{Pullman} case might be applied to permit the state through which the oil passes to levy a proportional property tax on oil

\textsuperscript{101} \textit{Prairie Oil & Gas Co. v. Ehrhardt}, 244 Ill. 634 (1910).
\textsuperscript{103} \textit{Pullman's Palace Car Co. v. Pa.}, 141 U. S. 18 (1891).
in transit. No part of the oil is in the state for the entire year, but a certain proportion of it is always there. Now, where oil leaves a state after tax day and where such such state does not base its assessment upon the quantity of oil produced, the oil may not be taxed at all for the year in which it was produced. It seems that the total quantity of oil in the pipe line passing any given point in the line during the entire year could be taxed on its market value in proportion that the pipe line mileage in the state bears to the entire pipe line mileage in all the states. Such tax would probably have to be levied by the state as a unit and distributed to the local subdivisions through which the pipe line would pass. Under this rule the oil in transit could not be subjected to more than one full property tax while in the pipe lines and collecting tanks at pumping stations. And each state rendering protection would receive some portion of the tax.  

A corporation owned and operated a pipe line from Oklahoma to Illinois across the State of Missouri. Oil was neither received nor delivered in Missouri, where it had paid a general property tax upon the pipe line. It had also paid a license in Missouri for the privilege of engaging in the business of transporting crude petroleum by pipe line. A Missouri statute required every foreign corporation engaged in business in the state to pay an annual franchise tax on one-tenth per cent of the par value of its capital stock and surplus employed in business in the state. And for the purpose of the tax the corporation was deemed to have employed in the state "that proportion of its entire capital stock and surplus that its property and assets in this state bear to all its property and assets wherever located." It was held that the franchise tax was invalid as the operation of the pipe line was interstate commerce not subject to taxation.  

Under a state income tax, however, the state could tax the income derived from transportation of property in interstate commerce; and the gains and profits derived from sales of property and transactions in interstate commerce may be included in the computation of net income.

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104 Writer of note in 22 Mich. L. R. 739, seems to think that the Pullman's Palace Car rule could be applied.

105 Ozark Pipe Line Corp. v. Moiner, 266 U. S. 555.

106 United States Glue Co. v. Oak Creek, 247 U. S. 321.
(d) Storage Tanks and Oil Therein.

Under decisions holding that oil in transit in interstate commerce cannot be taxed by a state, questions have arisen to what extent oil in storage tanks destined for interstate shipment may claim immunity from state taxation. It is generally held that oil in collecting tanks at pumping stations to the extent that such quantity is necessary to keep the oil moving in the pipe line is not subject to taxation. Nor is oil collected in tanks awaiting loading in tankers for shipment out of the state subject to taxation. But large quantities stored in large storage tanks whether intended for interstate shipment or awaiting favorable market conditions are taxable in storage. In Oklahoma where the gross production tax exempts equipment devoted to production the question has arisen whether large tanks not immediately connected with the wells are covered by the exemption.

Thus it was held that oil in tanks, located on pipe lines extending from fields of production to refineries in another state, some of which had remained in storage for several months in the tanks, which were of greater capacity than required for continuous operation of the pipe lines and at times contained a large quantity of oil was not in course of interstate transportation, but to have a local situs, and to be subject to local taxation. In this case there were 17 tanks of 55,000 barrels capacity each nearly filled with oil continuously for more than three years. The court allowed the assessment of the oil in 15 tanks as two were necessary for pumping purposes to keep the oil in transit. The case was affirmed by the circuit court of appeals, holding that the continuity of the interstate journey of such oil was so broken, and it so came to rest, as to render it subject to local taxation. In *General Oil Co. v. Crain*, a Tennessee statute providing for the inspection of oil and imposing an inspection fee of 25 cents per barrel was held not to impose an unconstitutional burden on interstate commerce as applied to oil coming from other states and ultimately intended for sale and distribution of other states but meanwhile stored in Tennessee for convenience of distribution and for reshipping from tank cars and barreling.

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108 Same case, 11 F. (2d) 967.
109 209 U. S. 211.
In an action to abate the levying of an ad valorem tax on a quantity of oil in storage on the ground that the taxation of the oil was an interference with interstate commerce, it appeared that no oil was sold at the river port except for export, and that the only business conducted there consisted in unloading oil from tank cars into storage tanks and the loading of the oil from the storage tanks aboard tankers for shipment to foreign ports. Oil was only kept in the storage tanks sufficiently long to await either the arrival of a ship or the accumulation of a sufficient quantity of oil to load a ship, requiring 300 to 500 railroad tank cars. On the authority of the Crain case it was held that the oil in the storage tanks was subject to state taxation, notwithstanding the commerce clause, since the storage in the state was not a part of a continuous interstate or foreign shipment.\(^1\) The case was reversed by the United States Supreme Court, holding that the oil was not subject to state taxation, since the storage in the state was part of a continuous interstate or foreign shipment.\(^1\) It would seem that this case, in effect, overrules the Crain case.

The gross production tax in Oklahoma is imposed upon oil and gas produced and is in lieu of the ad valorem tax upon the machinery, appliances, and equipment used in and around any well producing oil and gas and actually used in the operation of such well. The question arose whether a number of steel storage tanks erected for the purpose of storage of crude oil from the lessee's wells came within this exemption. The oil was pumped from the wells into small receiving tanks and from there conveyed through his own pipe line to the steel tanks in question in which the crude oil was stored until it could be marketed. These tanks were of 55,000 barrels capacity and were constructed from six to ten miles from the wells. It was held that these steel storage tanks and the pipe line connecting them with the receiving tanks of 500 to 2,000 barrels capacity were not exempt from the payment of the ad valorem tax under the gross production statute.\(^2\) The court laid down the rule that in order for property or equipment to be exempt from the payment of other taxes under the statute, such property must be an indispensable agency in the discovery and pro-

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\(^1\) *Carson Petroleum Co. v. Vial*, 166 La. 378.

\(^2\) *Same case*, 279 U. S. 95.

\(^3\) *Going v. Shaffer*, 89 Okla. 46.
duction of the petroleum, and must be used in and around a producing well and be actually used in the operation of such well. It seems equally clear that the oil stored in such tanks after the tax year in which it was produced will be subject to the ad valorem tax and that the gross production tax is only in lieu of all other taxes on the oil for the year in which it was produced.

(e) Tank Cars.

Tank cars are frequently owned by the oil producers themselves or they may be owned and built by corporations not engaged in the production of oil and leased to the oil producers. Ordinarily the same methods and rules of taxation are applied to them as to ordinary rolling stock. In Louisiana all rolling stock including tank cars is subjected to a state tax of 5¼ mills and to local taxes where the owner is a resident or a domestic corporation. Foreign owners who have acquired a domicile in Louisiana are subjected to the same local taxes. Non-residents and foreign corporations operating tank cars in Louisiana and who have not acquired a domicile for purposes of local taxation are taxed in addition to the state tax 25 mills per dollar on the valuation of the cars and this latter tax is in lieu of all local taxes.

To determine the number of tank cars employed within the state the mileage proportion has been resorted to. Thus where the corporation owned 500 tank cars employed in the United States and Canada which travelled over a total mileage during the year of 3,384,819 of which the total mileage in Louisiana was 169,450, the proportional number of cars assessed in Louisiana was 4,823. The company was taxed for this number of cars on the value of each car for state, parish and city purposes. The tax was sustained. The rule announced was that rolling stock is taxable in the municipality where its non-resident corporate owner has become domesticated by the appointment of an agent for the service of process. In a case involving the constitutionality of the Louisiana statute of 1917 which provided that the rolling stock belonging to non-residents and operated over the railroads in the state shall be assessed and taxed for all purposes, state and local, at the domicile de-

113 White Oil Corporation v. Flanagan, 153 La. 837.
clared by such non-resident; otherwise at the state capital, it was held that the village could tax the cars as the statute has placed them within the jurisdiction of the village where the owner has declared his domicile. The method used was to take that proportion of the total value which the car mileage within the state bore to the total car mileage both within and without the state.

In 1921 Louisiana enacted a statute that levied an annual tax of 25 mills on the assessed value of all rolling stock of non-resident owners having no domicile in Louisiana and operating cars in the state. Under this statute the Louisiana Tax Commission assessed 510 tank cars at 499,800 to a non-resident corporation without domicile in Louisiana. The tax was levied on this valuation at 301/4 mills, consisting of the general state tax of 51/4 mills and the additional levy of 25 mills in lieu of all local taxes. This additional tax is allocated to state purposes only. The assessment was sustained. This statute has been attacked in the federal courts as to the 25 mills provision and upheld. The total local taxes from which the non-resident is exempt usually exceed 25 mills. The exemption from local taxes to those who have paid the 25 mills tax is granted by Louisiana constitution which provides that "rolling stock operated in this state, the owners of which have no domicile therein, shall be assessed by the Louisiana tax commission, and shall be taxed for state purposes only, at a rate not to exceed forty mills on the dollar of assessed value." In a suit to enjoin the collection of the 25 mills tax it was held that this constitutional provision exempts from all local taxation non-residents paying the 25 mills tax imposed by the statute of 1921. And that since local taxes average about 25 mills there was no unjust discrimination against plaintiffs. The non-resident may either pay the state tax assessed under the statute of 1921, or, at his option, by becoming domiciled in a parish, pay instead of it the local taxes assessed within the parish. The bill for injunction was accordingly dismissed.

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114 Gulf Refining Co. v. Tillinghast, 152 La. 847.
115 Marr's Anno. Rev. Stats. of La., 1926 Supp., Act 109, Sec. 5.
116 Union Tank Car Co. v. Day, 156 La. 1071.
118 La. Const., 1921, Art. 10, Sec. 18.
The question has arisen as to what acts on the part of a non-resident are necessary to manifest that a choice of domicile has been made so as to subject him, or the corporation, to local taxation. A Texas corporation was assessed for local taxes on tank cars operated in Louisiana. B contended that its property was assessable for state purposes only because it had no domicile in Louisiana. It had a place of business in Louisiana and had designated an agent there for the purpose of service of process. The court held that the act of appointing a resident agent for the purpose of receiving service of process constituted an acquisition of domicile and rendered the corporation subject to local taxation. The Louisiana court had previously assumed that the same acts on the part of the corporation were sufficient to give it a domicile in Louisiana. The case was reversed, however, by the Circuit Court of Appeals which held that the oil company did not acquire a domicile in Louisiana by the appointment of an agent for the purpose of receiving service of process and was therefore not subject to local, but only to state taxation. The corporation did not consent in any way to have a domicile in Louisiana and no Louisiana constitutional or statutory provision purports to give its designation of an agent in Louisiana for the purpose of service of process against it the effect of conferring on it a Louisiana domicile. A non-corporate owner would not acquire a Louisiana domicile by designating a place of business and a resident agent to receive and accept service of process. These acts were insufficient for the acquisition of a domicile in a foreign state where the law of the foreign state does not provide for a foreign corporation acquiring a domicile in a state other than the one where it was created.

The corporation, having successfully resisted the collection of local taxes on the ground that it had not established a domicile in Louisiana, was sued by the collector for the amount of state taxes for the years in question upon the rolling stock employed in its business in Louisiana. It was held that since the foreign corporation had escaped local taxation by establishing that it had no domicile in the state it was now estopped to claim exemption from the state tax imposed on the rolling stock of non-resi-

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120 Simms Oil Co. v. Wolfe, 3 F. (2d) 36.
121 Simms Oil Co. v. Flanagan, 155 La. 565.
122 Simms Oil Co. v. Wolfe, 6 F. (2d) 504.
The court states that the method of taxation was fair and reasonable. The impracticability of taxing rolling stock of foreign owners in the local parishes led to the constitutional amendment in 1921 providing that rolling stock operated in the state owned by non-domiciliaries should be taxed by the state tax commission, and for state purposes only, at a rate not exceeding 40 mills. We have seen that the statute of the same year fixed the additional tax at 25 mills, which is the tax now resisted. The case was affirmed by the circuit court of appeals. The practice had been to take the number of cars for the preceding year as a basis for the succeeding taxable year, which practice was upheld by the state court. It was contended that when the tax was levied the number of cars for the year in question was known and that the number of cars for the preceding year could not be taken. But since the company had not contested the assessment for that year during the time required by law, it could not be heard on appeal.

Thus ends a long line of litigation in Louisiana over the taxation of tank cars; difficulties that have arisen only from the fact that tank cars may be subjected to either state or local taxation in the case of foreign owners depending on whether they have acquired a domicile in the state. Domestic owners are in all cases subjected to local taxation in addition to the general state tax of 5\(\frac{1}{4}\) mills. It seems that local taxing machinery is entirely inadequate to deal with the problem of taxing rolling stock. Lack of uniformity in rates and valuations must be the inevitable consequence. It seems to us that tank cars and rolling stock, whether owned by residents or non-residents, by domiciliaries or non-domiciliaries, demand a uniform system of valuations and taxation that can only be secured by vesting the entire jurisdiction over the taxation of that class of property in the state tax commission, and requiring that body to distribute the taxes to the local subdivisions.

In California a corporation, owning tank cars which it leased to shippers, was assessed a tax by the state board of equalization measured by the gross receipts from the operations of the company in the state. The tax was sustained under the constitutional provision authorizing the imposition of taxes on

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all car-loading companies which are carrying on business upon the railroads in the state. Under this provision oil tank cars are subjected to the same form of tax as other railroad rolling stock operated in the state. In Mississippi it was sought to assess a company with back taxes on its tank cars for a period of eleven years. The statute of 1926 provided for the assessment of non-resident corporations engaged in the business of operating and leasing cars for transportation of freight. The company was a New Jersey corporation engaged in building tank cars and leased them to lessees who were shipping oil and petroleum products. It was held the law was not retroactive so the assessment for back taxes was void. Prior to this time no law had fixed the situs for taxation of these cars in Mississippi and they were not taxable there before. The court states that generally the situs of a corporation within the state where it was incorporated will be considered or a situs of all its personal property until the enactment of law fixing taxable situs within the state where such property is used. In a case involving the right of Tulsa county to impose an ad valorem tax upon privately owned oil tank cars and leased to a refining company the tax was upheld. It was stated that oil tank cars owned by a person or corporation domiciled within the state and not used as a public service corporation, nor as a common carrier, are personal property and subject to an ad valorem tax. They are not taxable under the gross receipts tax law since the owner was not a “public service” concern nor a “common carrier” to which the gross receipts tax law applies.

2. Failure of Property Tax.

The property tax is unsuited for the purpose of valuing the lessee’s interest in the oil and gas in his leasehold. No one can predict the quantity in the ground. The Kentucky rule that the lease is to be assessed for what it will bring for cash at a fair, voluntary sale resolves itself into a mere matter of opinion as to what that value might be. Thus in practically all states where the property tax is applied the production in some form is attempted to be used as a basis of valuation and the tendency is not to assess undeveloped leases. A well may have

126 Union Tank Line Co. v. Richardson, 183 Cal. 409.
127 Miss. v. Union Tank Car Co., 151 Miss. 797.
128 Travis v. Dickey, 96 Okla. 256.
a supposed production of 40 barrels per day of which the lessor's share is five barrels daily. The year's production may be sold in the market at a figure depending on the market price of oil. For the purposes of assessment this figure has often been fixed at $10.00 per barrel. The lessee's interest because of the risk of the business has a smaller market value and for purposes of taxation may be assessed at $5.00 per barrel. On that basis the lessee's interest in the leasehold would be valued at $17,500 and the lessor's royalty interest at $5,000 for the taxable year. Under the property tax in West Virginia prior to the leasehold law, it was practically impossible to tax the lessee's interest under an oil and gas lease. *State v. South Penn Oil Co.* case had held that the lessee's interest could not be taxed as land because less than a freehold estate.128 And *Carter v. Tyler County Court* had held that oil wells could not be taxed as personal property because the oil in the ground was realty, and only became personalty when it reached the surface.129 Under these decisions leaseholds could not be taxed as real estate or personal property. No oil could be found by the assessor on tax day, January 1st, as all storage tanks were then empty. The only thing assessable to the lessee was $500 to $1000 in machinery and fixtures used around the well. The legislature of West Virginia then enacted a leasehold tax law in place of a production tax law recommended by the department of taxation. This law has been difficult to enforce. Under it the assessor used the production of the oil well as the basis for valuations. Thus in the case supposed the lessee would be assessed at $17,500 or at $5.00 per barrel of daily production. This figure of production was taken on tax day January 1st. Where the well continually declined in production during the year the lessee will be overtaxed who pays a tax on the basis of what the well produced on January 1st. On the other hand, where a well comes in just after tax day it goes tax free for the rest of the year. In West Virginia it has been almost impossible to ascertain the value of gas leaseholds as there have been no means to determine what each well from the leasehold is producing.130 Obviously the property tax in any form is unsuitable for the taxation of

128 Note 58, supra.
129 Note 55, supra.
oil and gas. It fails to do justice to either the state or to the
lessee and lessee.

3. Locus of Taxation.

The place of taxation of any interest designated as real
property is at the place where situated. Personal prop-
erty in the absence of statute fixing its situs has usually
been considered taxable at the residence of the owner. Thus
the Kentucky statute of 1894 made “coal, oil, or gas privileges,
by lease or otherwise,” on the land of another, taxable in the
county in which the property is situated. Prior to that statute
oil and gas leases were taxable in the county of the residence
of the owner. In Texas the question arose whether royalty
oil is realty and taxable in county where produced. It was cont-
tended that royalty oil is personal property and taxable only in
the county of the owner’s residence. It was held taxable in the
county where produced since oil in place is realty under the
Texas law. The case was affirmed by the Circuit Court of
Appeals and by the United States Supreme Court. The
lessor was assessed upon the basis of 723 barrels of daily pro-
duction at $10.00 per barrel. This represented the valuation
of the oil to be produced for the taxing year and is an assessment
of the oil in place and therefore property taxable as real estate
under the Texas law in the county where produced. The same
would be true in any other state.

IV. Gross Production Tax.

1. Oklahoma.

That the property tax is not adapted to the taxation of oil
and gas interests has been made apparent from the fact that
taxing administrators almost everywhere attempt to use pro-
duction as a basis of valuation and usually do not tax unde-
veloped leases. Six of the oil producing states have production
taxes in whole or in part. A production tax is easy of adminis-
tration, scientific, and rests upon the correct theory at basis of
all taxation which is income. Oklahoma levied the first tax on
the production of oil and gas in 1908. It imposed a tax of one
half per cent on the gross receipts from the total production of

131 Kirk v. Western Gas & Oil Co. (Ky.), 37 S. W. 849.
132 Waggoner v. Wichita County, 298 F. 818.
133 3 F. (2d) 962; 273 U. S. 113.
petroleum and in addition to ad valorem taxes. In 1915 the tax rate was increased to two per cent of the gross value of production of petroleum and declared to be in lieu of the ad valorem property tax upon the equipment and machinery in and around any well and used in the actual operation of the producing well. Under the 1916 act every producer of petroleum was required to make a quarterly return to the state auditor showing the gross amount produced and the actual cash value at the place of production. A tax of three per cent was imposed payable to the auditor on the gross value of production less the royalty interest. This tax was declared to be in full and in lieu of all taxes by state, county, city, towns, township, school districts and other municipalities, but oil in storage on tax day was subject to the ad valorem tax.

The statute of 1916 further provided that upon complaint of any person who claims to be taxed at too high rate the state board of equalization shall take testimony to determine whether the tax imposed is greater or less than the general ad valorem tax for all purposes would be on the property of such producer subject to taxation in the district where same is situated in lieu of which the tax is levied. The board is empowered and required to raise or lower the rates imposed to conform thereto. This duty is mandatory upon the board when complaint is filed. That is, it becomes the duty of the board to determine whether the taxes imposed on a gross production basis is greater or less than the general ad valorem tax would be on the property of such producer and, if so found, to adjust the gross production tax rate so that taxes levied under either method would be equal in amount. Cases may arise under this statute by appeal to the state board from the decisions of the state auditor who is empowered to increase the gross production tax returned by the producers. How, as a practical matter, the board is going to determine from testimony when there is equality between the taxes levied under each method is not so clear.

There has been considerable controversy in Oklahoma as to the status of departmental leases for the purposes of taxation covering the Indian lands. The law seems to be settled that departmental leases are not subject to the gross production tax, but the equipment used in the production of oil is subject to

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234 In re Gross Production Tax of Exchange Oil Co., 80 Okla. 52.
the ad valorem tax. In ordinary leases the equipment used in production of oil is not assessed for ad valorem taxes, but they are subject to the gross production tax of three per cent levied separately upon the working and the royalty interests on the actual cash value of the oil produced and in lieu of other taxes upon property used directly in the production of oil.

In the first case that arose in Oklahoma attempting to tax departmental leases the lessee returned the value of the physical property excluding any value for the leases which were located on the Osage Indian Reservation. The state board of equalization included the value of the leases by increasing the value returned tenfold. The referee reduced this value somewhat but finds that the oil company is taxable on the full value of its property, tangible and intangible, and is not exempt from taxation upon the theory that it is a federal agent or that it holds a franchise from the federal government. The leases are not specifically mentioned but their value must have been included. The report of the referee is confirmed although the court takes occasion to say that oil in the ground cannot be taxed to the lessee, but must be taxed to the landowner, if at all.¹³⁵ On appeal to the United States Supreme court it was held that the leases were not taxable by the state and the state court was reversed.¹³⁶ It was stated that a tax upon the leases was a tax upon the power to make them, and could be used to destroy that power. Since the leases could not be taxed themselves, they could not be taxed by taxing the stock whose only value was their value, or by taking the stock as evidence or measure of their value. The tax on the leases having been held invalid left the tax on the physical property as returned by the company standing.

The gross revenue tax of 1908, previously referred to, was held by the U. S. Supreme court to be an occupation or privilege tax and invalid in so far as that was levied upon agencies or means of the federal government in dealing with the Indian tribes.¹³⁷ This tax was in addition to ad valorem taxes. The gross production tax of 1915 was then enacted in lieu of ad valorem taxes upon property immediately used in the production of oil. This was not imposed upon production from Indian

¹³⁵ In re Indian Ter. Ill. Oil Co., 43 Okla. 307 (1914).
leases nor upon federal agencies. But instead an ad valorem tax was levied upon the personal property, "including leases when the same are subject to be taxed by the state," devoted to the production of oil and gas when the same is carried on and conducted through a federal agency. The constitutionality of the 1915 act was sustained by the state court.\textsuperscript{138} It was also stated in the \textit{Wolverine} case that the gross production tax was an occupation tax. This point is overruled in a subsequent case holding that the gross production tax is a property tax and not an occupation tax.\textsuperscript{139} The \textit{Wolverine} case was not appealed to the U. S. Supreme court.

The present gross production tax in Oklahoma was enacted at the extraordinary session in 1916. It provided for a tax of three per cent of the gross value of the production of petroleum and of natural gas, less the royalty, from every producer of oil and gas within the state. The royalty owners were separately taxable at the same rate. The act provides for no exemptions except royalty interests of the State of Oklahoma and of the United States. The tax is in full and in lieu of all other taxes, state and local, upon the minerals as property, upon leases and upon machinery, appliances and equipment used in and around any well producing petroleum or natural gas and actually used in the operation of such well; and also upon the oil and gas during the tax year in which the same are produced.\textsuperscript{140} In this statute no exception is made in the application of the tax with respect to Indian leases. A case soon arose involving the question of power of the state to impose and collect the tax provided for by this act of 1916 where the owner of the property sought to be taxed is engaged in the production of oil and gas in what formerly constituted the tribal lands of the Osage Indians. The power was upheld by the state court upon the ground that the tax is not upon the agency or the means employed by the producer, but upon the production of oil and gas, and is valid as a tax on property, as such, without regard to the agency employed in its production. The tax, it was said, is imposed upon the commodity which the company produced, and is levied in full and in lieu of certain of the other property.

\textsuperscript{138} \textit{In re Gross Production Tax of Wolverine Oil Co.}, 53 Okla. 24.
\textsuperscript{139} \textit{Bergin Oil & Gas Co. v. Howard}, 82 Okla. 176.
\textsuperscript{140} Session Laws of Oklahoma, 1916, Ch. 39, Sec. 1.
and as a substitute therefor.\textsuperscript{141} The same conclusion was reached in another case that the tax was imposed upon the production of oil and gas as property, and valid without regard to agency employed in production.\textsuperscript{142} Both cases were reversed in the U. S. Supreme Court without opinion.\textsuperscript{143}

In a suit to recover a gross production tax paid under protest, it appeared that plaintiff was the owner of Indian allotment lands from which he received an oil and gas royalty on which the three per cent tax had been levied. He was denied recovery in the state court as the tax had not been paid "at the time and in the manner provided by law," in the words of the statute. Conceding that the lands were exempt, the court holds that when the minerals were produced they became personal property and subject to the tax.\textsuperscript{144} No federal agency was exercising supervision over the property in question. The act of Congress provided that all lands allotted shall be nontaxable while the title remains in the original allottees but not to exceed 21 years from the date of patent, which period had not expired. The case was reversed on appeal to the U. S. Supreme Court, holding that it was not a tax on oil and gas severed from the land, but was a tax upon the right reserved by the lessor as owner of the fee and that the tax had been unlawfully exacted.\textsuperscript{145}

The question has arisen whether lands purchased with funds derived from oil royalties are impressed with the same restrictions as to nontaxability as the restricted allotment from which the royalties were received. It was held that they were not.\textsuperscript{146} The lands were not exempt from taxation before they were purchased and the mere fact that they were purchased with royalty funds which were exempt did not impress the lands with the same character. The deed contained a clause that the lands were inalienable without the consent of the Secretary of the Interior but the court held that that did not operate to confer exemption from taxation. The same conclusion was sustained by the U. S. Supreme Court in another case. There non-Indian lands were purchased for Indian minors with money derived

\textsuperscript{141} \textit{Large Oil Co. v. Howard,} 63 Okla. 143.

\textsuperscript{142} \textit{Whitehill v. Howard,} 63 Okla. 176.

\textsuperscript{143} \textit{Large Oil Co. v. Howard,} 248 U. S. 549.

\textsuperscript{144} \textit{Carpenter v. Shaw,} 134 Okla. 29.

\textsuperscript{145} \textit{Carpenter v. Shaw,} 280 U. S. 363.

\textsuperscript{146} \textit{Jones v. Whittow,} 80 Okla. 131.
from departmental lease royalties. The deeds contained similar restrictions. The land was leased under a departmental lease and Oklahoma levied the gross production tax upon the lease holder. It was held that the Secretary had no power to exempt the land from taxation and that the tax was not forbidden as a tax upon a federal instrumentality.\(^\text{147}\) From these cases it would follow that the exemption from taxation adheres to the lands. Only while in the hands of the original Indian holders. And the exemption of the land carries with it the exemption of the products from the land from taxation. But the lands having once become taxable cannot acquire immunity by being purchased by tax exempt funds.

It is clear from the foregoing cases that the gross production tax does not apply to oil or gas derived from departmental leases. The gross production tax law of 1915 expressly exempted departmental leases from its operation but provided that all persons or corporations operating leases through a federal agency should be taxed on the ad valorem basis.\(^\text{148}\) Under that law it would seem that all equipment used in the production of oil could be taxed on the ad valorem basis. That law was replaced by the law of 1916 in which the gross production tax was made applicable to all lands and nothing was said about ad valorem tax.\(^\text{149}\) That law was held invalid in so far as it attempted to apply the gross production tax to departmental leases. The practice in Oklahoma is to tax the equipment on departmental leases under the ad valorem tax.\(^\text{150}\) The law of 1916 providing for no way to tax equipment on departmental leases the general ad valorem tax on all property would apply to the personal property devoted to production of oil on departmental leases.\(^\text{151}\) There is no U. S. Supreme Court decision to the contrary.

Under the 1915 law one-half of the gross production tax was retained by the state and the other half distributed to the county from whence it was collected for the benefit of the common schools.\(^\text{152}\) Under the law of 1916 two-thirds of all gross production tax was retained by the state and the one-third distributed to the county from whence it was collected for the benefit of the county schools.

\(^{147}\text{Shaw} v. \text{Gibson-Zahniser Oil Corp.}, 276 U. S. 575.\)

\(^{148}\text{Session Laws of Okla., 1915, Ch. 107, Sub. Div. A, Sec. 1.}\)

\(^{149}\text{Note 140, supra.}\)


\(^{151}\text{Note 22, supra.}\)

\(^{152}\text{Note 148, supra, Sec. 4. Bd. of Comrs. of Creek County} v. \text{Alex- ander}, 58 Okla. 123.\)
production taxes levied and collected are retained by the state and one-third is distributed to the county from whence the oil and gas was produced. One-half the latter sum is credited to the common school fund and the other half to the road and bridge fund.\[^5\]

2. **Louisiana.**

We have seen that under the property tax Louisiana valued oil leases on the basis of production.\[^1\] In 1922 Louisiana imposed by Act 140 a severance tax of three per cent on the gross market value of the production of all mineral oil and natural gas produced in the state. The constitutionality of this act was sustained and the severance tax was held to be an excise tax upon the privilege of severing and not a property tax. Therefore the constitutional provision which limited property taxes for all state purposes to $5\frac{1}{4}$ mills a year was not violated. And the constitutional provision requiring that taxes shall be uniform on the same class of property applies only to property taxes and not to excise taxes. The severance tax is levied but once, and is in lieu not only of all other state taxes, but also of all parish municipal, and local taxes and licenses.\[^2\] The case was affirmed without opinion by the U. S. Supreme Court.\[^3\]

In 1928 the severance tax law was radically changed by levying the tax based on the quality of oil produced. Thus oil of 28 gravity and below was taxed at four cents per barrel of 42 gallons each, while oil of 43 gravity or above was taxed at eleven cents per barrel. There were four intervening grades specified taxed at rates intermediate between the two mentioned. The higher gravity oils are the lightest and possess the highest gasoline content. Gas was taxed at one-fifth cent per 1,000 cu. ft. measured at 10 oz. pressure.\[^4\] In a suit to enjoin the enforcement of the statute the preliminary injunction was denied. The court was of the opinion that a severance tax on petroleum based on gravity of oil was founded upon a reasonable classification. One-fifth of the amount collected under the severance tax shall be allocated to the parish from within which

\[^{1,5}\] Session Laws of Okla., 1916, Ch. 39, Sec. 5.

\[^{2,5}\] Note 74, supra.

\[^{3,5}\] Gulf Refining Co. v. McFarland, 154 La. 251.


\[^{5,5}\] Acts of La., 1928, Act 5, Sec. 2 (7) (8).

\[^{6,5}\] Ohio Oil Co. v. McFarland, 28 F. (2d) 441.
such tax is collected, but not to exceed 200,000 to any parish in any one year. Since Louisiana had no law under which taxes under an unconstitutional statute could be recovered, and since the facts were in dispute, the Supreme Court vacated the order denying a temporary injunction and directed further proceedings as to finding facts. The case having been reconsidered by the district court, the tax was sustained. The Louisiana constitution of 1921, Art. 10, Sec. 21, authorized the levy of taxes on the severance of natural resources, and provides that natural resources may be classified for purposes of taxation and that taxes may be levied either upon "quantity or value" of the product at the time and place of severance. The court sustains the classification under the act of 1928 as reasonable and as resting upon some ground of difference having a fair and substantial relation to the object of the legislation. The case was affirmed and it was held that a classification based upon gravity will satisfy the constitutional requirement that taxes on the severance of natural resources may be based on either quantity or value. Gravity indicates the gasoline content and the oil industry uses gravity as basis for fixing price of oil.

Prior to the severance tax Louisiana did not assess leases but imposed a gross receipts tax in lieu thereof. Since the severance tax of 1922 producing or non-producing leaseholds have not been taxable except under the severance tax on the gross market value of the oil and gas and now under the tax based upon gravity. The Louisiana severance tax, however, is not in lieu of the tax on equipment used in the production of oil and gas. Personal property used in the production of oil and gas is taxable under the ad valorem tax at its actual cash value. In this respect the Louisiana severance tax differs from the gross production tax in Oklahoma which exempts equipment used in production on ordinary oil leases.


We have seen that the Kentucky constitution requires that all property shall be assessed for taxation at its fair cash value estimated at the price it would bring at a fair, voluntary sale.

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159 Ohio Oil Co. v. Conway, 279 U. S. 813.
160 Ohio Oil Co. v. Conway, 281 U. S. 146.
161 Note 71, supra.
At the extraordinary session in 1917 the Kentucky legislature enacted what it called a license or franchise tax which was imposed upon every producer of oil "in lieu of all other taxes on the wells producing said oil imposed by law" equal to one per cent of the market value of all oil produced in the State for State purposes and counties were authorized to impose a like tax not to exceed one-half per cent. The act was amended in 1918 and the tax was made "in lieu of all other taxes on the wells producing said crude petroleum." The construction of this "in lieu" clause arose in a case where a lessee was the owner of a block of leases in Kentucky. He had been assessed an aggregate sum covering all the leases excluding five acres around each producing well which was estimated as the territory that might be drained by each well. This was in addition to the tax on the production of the wells. It was contended that the leases conferred no property right until after the oil and gas had been found and, therefore, not taxable, which contention was denied. It was further contended that the gross production tax under the "in lieu" clause was intended to and does include the value of the leases on the property from which the oil is produced. The court also denied this contention. It was stated that the gross production tax was not intended to be in lieu of the ad valorem or property tax to which the oil lease covering the producing territory was subject. And that it was not within the constitutional power of the legislature to substitute a gross production tax for the ad valorem tax had that been the intent. It was accordingly held that the production tax on the oil produced is separate and distinct from the ad valorem tax to which the leases are subject and that it cannot operate to exempt them from the property tax.

In the next case that arose under this statute the lessee had returned the leases at a valuation excluding the producing wells. The board of supervisors increased this value five times basing the raise upon the fact that the lessee had merely listed the leases without the producing wells. The contention was again advanced by the lessee that the production tax was intended to be in lieu of all taxation on oil leases. But the court construed this clause to mean that "there should be no other

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264 Acts of Ky. Extraordinary Session, 1917, Ch. 9, Sec. 1.
265 Acts of Ky., 1918, Ch. 122, Sec. 1.
266 Raydure v. Bd. of Supervisors, 183 Ky. 84.
license tax” imposed, and adhered to the former holding that the production tax was not a substitute for the ad valorem tax. The wells were held subject to the ad valorem tax and the tax as raised sustained.\textsuperscript{167} It is clear that the “in lieu” clause is not a substitute for the ad valorem tax on the leases, if they should be taxed, but it seems to do violence to the language of the statute to hold that the clause merely means that no other license taxes should be imposed. It seems clear that the legislature intended by this clause that the production tax should be in lieu of all other taxes, ad valorem as well as license taxes, on producing wells. The construction was probably necessary to sustain the statute in view of the holding in the Raydure case that the legislature had no constitutional power to abolish the ad valorem tax but that the two must stand together.

The constitutionality of the gross production statute was further attacked in a suit seeking to recover taxes paid thereunder. The construction in the Raydure and Associated Producers cases that the act imposes a license and occupation tax and not a property tax is adhered to and recovery of the tax denied. The court points out that the statute has been twice upheld by the court and two successive legislatures have refused to modify it. There is a dissenting opinion to the effect that the whole license tax is unconstitutional because it cannot be separated from the exemption of the ad valorem tax, which exemption the court has held void.\textsuperscript{168} The case was affirmed on appeal to the U. S. Supreme Court.\textsuperscript{169} The main contention in the state court was that the tax was a property and not a license tax and therefore invalid under the Kentucky constitution requiring uniform taxation. This court acquiesces in the construction of the Kentucky court that the statute imposes a license tax and holds that the license tax is not invalid because the ad valorem tax is imposed on the same property. In all these cases Section 1 of the statute has been the subject of controversy which contains the “in lieu” provision.

The subsequent sections of the statute deal with the collection of the production tax from the transporter who is given right of reimbursement against the producer. Section 3 of the Act of 1918 provides that the tax “shall be imposed and attach

\begin{itemize}
  \item \textsuperscript{167} \textit{Associated Producers’ Co. v. Bd. of Supervisors}, 202 Ky. 538.
  \item \textsuperscript{168} \textit{Swiss Oil Corp. v. Shanks}, 208 Ky. 64.
  \item \textsuperscript{169} \textit{Swiss Oil Corp. v. Shanks}, 273 U. S. 407.
\end{itemize}
when the crude petroleum is first transported from the tanks
or other receptacles located at the place of production.” In a
suit to enjoin the collection of the tax the Federal District
Court of Kentucky construed the Act of 1917 as an occupation
tax but held that the production tax under the Act of 1918 was
a property tax, basing this conclusion upon the changed form
of the “in lieu” clause in the statute of 1918 from that contained
in the 1917 act, contrary to the holding of the Kentucky court in
the three previous cases considered, and that the tax was invalid
in so far as it was imposed on oil in interstate commerce. The
statute is invalid with respect to any oil that is delivered from
the producers’ tanks into pipe lines for distribution in inter-
state commerce.\textsuperscript{170} Under section 3 no tax is imposed until the
oil is first transported and the court holds that oil destined for
other states is then already in interstate commerce and untax-
able. This case has not been appealed and would seem to be
final authority on the question decided.

It is thus apparent that it would be necessary to amend
the Kentucky constitution before there can be a gross production
tax is lieu of the ad valorem tax on oil leases and property used
in the production of oil. At present the oil interests in Ken-
tucky are subjected to both taxes. While the production tax
is levied at a low rate the ad valorem tax is unsuitable for the
 taxation of oil and gas interests. The remedy would be to amend
the constitution, abolish the ad valorem tax and increase the
gross production tax so as to make it substantially equivalent to
the ad valorem tax in amount on other property, and make
the tax attach before the oil has entered into interstate com-
merce. It should be a tax in lieu of other taxes in fact.

4. Minor States.

Arkansas enacted a severance tax in 1923 levied upon the
severance of all natural products from the soil, including oil
and gas, at the rate of $2.50 per cent of the gross cash market
value of the total production of such natural resources.\textsuperscript{171} Oil
taken from beds or bars of navigable rivers and lakes, or from
any other lands owned by the State, pays a severance tax of
one-half cent for each gallon of oil.\textsuperscript{172} This severance tax is

\textsuperscript{170} Eastern Gulf Oil Co. v. Ky. Tax Com., 17 F. (2d) 394.
\textsuperscript{172} Acts of Ark., 1929, Act 212, Sec. 1.
separately assessed on the working interest and the royalty interest. Leaseholds are not assessed. The equipment is assessed and taxed ad valorem.\textsuperscript{173}

Texas levies a tax of one-twentieth per cent of the market value of crude petroleum produced which is in addition to the gross receipts production tax on the same. Producers must make reports of production same as for the gross production tax. This tax is levied for the requirements of the commission.\textsuperscript{174} Every oil producer must report quarterly to the Comptroller the total amount of oil produced from each well and the average market value thereof and shall pay an occupation tax of two per cent of the value of the total amount of oil produced at the average market price.\textsuperscript{175} And all gross receipts production taxes shall be in addition to all other taxes now levied by law. But counties of cities may not levy an occupation tax.\textsuperscript{176}

It thus appears that the gross production tax and the ad valorem tax are both levied on oil and gas in Texas. While oil and gas leaseholds are taxable, many counties refuse to tax non-producing leases. Producing leases are assessed at value per barrel based on average daily settled production, as we have seen, and equipment is assessed as personal property.\textsuperscript{177} The court has held that the gross production tax on oil wells is a privilege tax on the occupation of owning, controlling, or manning oil wells, and not an ad valorem tax, and therefore does not violate the constitution fixing the rate of taxation.\textsuperscript{178}

Montana originally levied an oil producers’ license tax of one per cent of the total gross value of all petroleum for exclusive state use. The total gross value of all petroleum was determined by taking the total number of barrels monthly at the average market value for the month. Producers must report annually to the State Board of Equalization.\textsuperscript{179} This tax was increased to two per cent in 1923.\textsuperscript{180} This tax is apparently not in lieu of property taxes.\textsuperscript{181} \textit{Mid-Northern Oil Co. v. Walker,}

\begin{itemize}
\item \textsuperscript{173} Methods of Assessment of Oil & Gas Properties, Frank Orr, 1926 Proc. Nat. Tax Assoc. 117.
\item \textsuperscript{174} Texas Stats., 1928, Art. 6032.
\item \textsuperscript{175} Ibid., Art. 7071.
\item \textsuperscript{176} Ibid., Art. 7078.
\item \textsuperscript{177} Note 173, supra.
\item \textsuperscript{178} Producers’ Oil Co. v. Stephens (Tex. Civ. App.) 99 S. W. 157.
\item \textsuperscript{179} Mont. Rev. Codes, 1921, Ch. 186 Secs. 2338, 2400.
\item \textsuperscript{180} Ibid., 1927, Supp.
\item \textsuperscript{181} Note 17, supra.
\end{itemize}
the only Montana case construing the oil producers’ license tax, has already been considered.\textsuperscript{182} No cases have arisen from New Mexico and Wyoming and their methods of taxing oil and gas have already been considered.\textsuperscript{183} The method of assessment in the two states is practically the same. In Wyoming the producers return the amount of oil and gas to the State Board of Equalization which board determines the average market value per barrel. This is certified to the county assessors in the counties where the oil is produced. This is in lieu of taxes on the land. Surface improvements and equipment used in the production of the oil and gas are assessed and taxed ad valorem.\textsuperscript{184}

California, one of the three large oil producing states in the country, has neither a production nor an income tax under which to tax oil and gas interests. Aside from the corporate franchise tax of 1.8 per cent, previously noted,\textsuperscript{185} all oil and gas interests must be taxed under the ad valorem tax. There has been an attempt to administer it on the production basis.\textsuperscript{186} The state also allows for depletion of oil and gas properties.\textsuperscript{187} There is a statement that California has a valuation system for oil and mineral properties based on net receipts and that a net production tax is more equitable than a tax on gross production.\textsuperscript{188} We find nothing in the statutes or decisions of California sustaining that statement. If correct, it is at most only an extra-legal practice which has probably been overstated. The report of the California Tax Commission states that “for nearly two decades, California has stood almost stationary in tax reform.”\textsuperscript{189} Nor does this report contain any recommendations with respect to the taxation of oil and gas interests, except that the question of a personal income tax be submitted to popular vote.\textsuperscript{190} And this bears only very remotely on the subject of oil and gas taxation.

An instance of the application of the property tax in Cali-

\textsuperscript{182} Notes 77, 78, 79, supra.
\textsuperscript{183} Notes 18, 19; 31, 32, supra.
\textsuperscript{184} Note 173, supra.
\textsuperscript{185} Note 5, supra.
\textsuperscript{186} Note 66, supra.
\textsuperscript{187} Note 6, supra.
\textsuperscript{189} Final Report of Calif. Tax Com. to Governor, 1929, p. 37.
\textsuperscript{190} Ibid., pp. XXII-XXIV.
California is shown from the *Birch Oil Co.* case where it had a 21 acre tract, containing 8 wells, producing 138,601 barrels, assessed at 645,120 and equalized at 600,000 by the board of equalization. The Fullerton Oil Co. on the same number of wells, producing 108,982 barrels, was assessed at 34,915 and equalized at 47,155. The Birch property had a gross annual income of $290,000 of which operating expenses were $200,000, leaving a net income of $90,000. Other property in the county was assessed at one-third of its value. Geologists and experts valued the Birch property at from $400,000 to $539,000. The assessor testified that he “estimated this piece of property at $1,955,175.” It was held that the inequality was so great that the assessment could not be upheld.\(^1\)

It is difficult to understand why two different oil leases producing nearly the same amounts should be assessed at such disproportionate figures. Nothing is shown upon which the assessor and the board of equalization based their valuations in either of the two instances. It is apparent that the system of taxation of oil and gas interests in California does not conform to present needs and that a tax based on production should be substituted for the present ad valorem tax on the leases.

At the extraordinary session of the legislature of West Virginia in 1925 a production tax was enacted. The statute levied a tax “upon every person engaging or continuing within this state in the business of mining or producing for sale . . . oil, natural gas, . . . the amounts of such tax to be equal to the value of the articles produced as shown by the gross proceeds derived from the sale thereof by the producer . . . multiplied by the respective rates as follows: oil one per cent; natural gas one and seventeen-twentieths per cent . . . The measure of this tax is the value of the entire production in this state, regardless of the place of sale or the fact that deliveries may be made to points outside the state.’’\(^2\)

In a case that arose under this statute the complainant was producing and purchasing natural gas in West Virginia which it transported through pipe lines into Pennsylvania and Ohio where it was sold. Most of the gas passed into interstate commerce by continuous movement from

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\(^1\) *Birch v. Orange County* (Cal. App.), 262 Pac. 788. See also same case, 200 Pac. 647.

\(^2\) Acts of W. Va. Extraordinary Session, 1925, Ch. 1, Sec. 2a.
the wells. It was held that the state may not treat the gross proceeds of complainant’s sales outside the state as the worth of its gas within the state, but it may enforce the act upon the value thereof within the state, and before it enters interstate commerce. The case was affirmed by the United States Supreme Court stating that the plain result of the opinion and final decree below is to require that the tax be computed upon the value of the gas at the well, and not otherwise. And it was held that a state may, without violating the commerce clause, lay a privilege or occupation tax on producers of natural gas reckoned according to value of that commodity at the well.

It is obvious from these decisions that the Kentucky statute will only need redrafting so as to levy the tax at the wells, and not impose it when the oil is first transported from the tanks into the pipe line.

While Oregon is not one of the oil producing states it has a statute which provides that in addition to taxes, now provided by law, every oil company doing business in the state shall pay to the state a license tax of three per cent upon the gross earnings of the company within the state. The statute further defines an oil company as any non-resident engaged in buying or selling petroleum products within the state, and all persons doing business as representatives of any person engaged in buying and selling petroleum products produced by non-residents and whose business done annually amounts in gross to 25 per cent of the total annual gross receipts of such persons from all lines in which he deals. In an action by the State to recover taxes upon the gross earnings it was stated by the court that a statute which taxes alike the gross earnings of residents and non-residents is not void or a regulation and taxation of interstate commerce. And since all who fall below the 25 per cent are exempt, residents as well as non-residents, the statute does not discriminate against non-residents. The case has not been in any other courts.

This survey shows that only two of the oil and gas producing states, Oklahoma and Louisiana, have an approved system for the taxation of these natural products. In Oklahoma the

193 Hope Natural Gas Co. v. Hall (W. Va.), 135 S. E. 582.
194 Hope Natural Gas Co. v. Hall, 274 U. S. 284.
195 Note 170, supra.
gross production tax is in lieu of the ad valorem tax on leases as well as the equipment immediately devoted to the production of oil and gas. As to departmental leases where the gross production tax has been held invalid, the ad valorem tax is imposed on the equipment. Louisiana has an excellent system of severance tax which is in lieu of all other taxes on the leases but the equipment used in the production of oil is taxed under the ad valorem tax. To this list may be added Arkansas which imposes a severance tax and does not otherwise tax leaseholds, and which taxes equipment of oil wells ad valorem. Kentucky has an unworkable ad valorem tax under which both developed and undeveloped leases as well as equipment used in the production of oil are taxed. This tax is in addition to its gross production tax. Texas and Montana have production taxes in addition to the ad valorem taxes. Likewise with the recent gross proceeds tax in West Virginia which is only in addition to the ad valorem tax. None of the states, save these seven, have a production tax and the exclusive ad valorem tax prevails. The ad valorem tax is especially unadapted for taxing the leases since their value cannot be determined and any assigned value by assessors is only conjectural. No one knows what the extent of an oil reservoir is in the ground until it is brought to the surface. The oil companies favor the gross production tax in lieu of other taxes. It is favored because of the hazards inherent in the oil business; because it is the most fair and equitable method to tax oil; because any other method of assessment is of necessity a guess; and because an "in lieu" tax is easily and cheaply ascertained, reported and paid.197

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(To be concluded in May issue.)

197 Note 173, supra.