1932

Taxation of Oil and Gas Interests (Continued)

Charles Gustav Haglund

Follow this and additional works at: https://uknowledge.uky.edu/klj
Part of the Oil, Gas, and Mineral Law Commons, and the Tax Law Commons
Right click to open a feedback form in a new tab to let us know how this document benefits you.

Recommended Citation
Haglund, Charles Gustav (1932) "Taxation of Oil and Gas Interests (Continued)," Kentucky Law Journal: Vol. 20 : Iss. 4 , Article 6.
Available at: https://uknowledge.uky.edu/klj/vol20/iss4/6

This Article is brought to you for free and open access by the Law Journals at UKnowledge. It has been accepted for inclusion in Kentucky Law Journal by an authorized editor of UKnowledge. For more information, please contact UKnowledge@lsv.uky.edu.
TAXATION OF OIL AND GAS INTERESTS. (Continued.)*

V. INCOME TAXES.

Of the petroleum producing states only Oklahoma and Arkansas have income tax laws. The Oklahoma income tax law is purely personal and the rates are low. The law was enacted in 1915, amended in 1917, and again amended and re-enacted in its present form in 1921.198 The law as originally enacted and re-enacted in 1921 levies a tax upon every person in the state upon the entire net income from all sources. A like tax is levied upon the entire net income derived from all property owned, business, trade or professions carried on in the state by non-residents. Under the law of 1921 husband and wife having separate incomes liable to taxation may make separate returns. The rates in 1915 were reduced in 1917 and the rates of the latter year were carried into the 1921 law. Under Section 7, $3,000 is exempt from taxation. On the first $10,000 of taxable income the rate is 7½ mills; on the next $15,000 the rate is 15 mills, and on all excess 20 mills. Corporations are not subject to the income tax; it is entirely a personal tax with liberal exemption and at low rates.

The Arkansas income tax law was enacted in 1929,199 and in Article II, Section 3(a), it imposes a tax upon the entire net income of every resident, individual, trust or estate. The rates are progressive. The first $3,000 of taxable income is taxed at 1 per cent, the next $3,000 at 2 per cent, the next $14,000 at 4 per cent, and all in excess of $25,000 at 5 per cent. The same Section (b) imposes a tax on every domestic corporation with respect to carrying on or doing business equivalent to 2 per cent of its entire net income; and every foreign corporation doing business within the state is taxed annually equivalent to 2 per cent of a proportion of the entire net income. And under subdivision (c) a like tax is imposed upon the entire net income from all property owned and from every business, trade or occupation carried on in the state by individuals, corporations, partnerships, trusts or estates, not residents of Arkansas. In section

* Continued from March issue.
198 Session Laws of Okla, 1915, Ch. 164. Ibid., 1917, House Bill No. 350. Ibid., 1921, Ch. 44.
16 exemptions are allowed of $1,500 to single persons and $2,500 to heads of families, and in addition, $400 for each dependent under 18, or incapable of self-support.

The laws are alike with respect to the jurisdiction exercised and are based upon erroneous principles in so far as they undertake to tax the income of residents which is derived from without the state. No state should tax any income except that derived within its borders, and that should be taxed alike to residents and non-residents. No case has arisen under the Arkansas law, but several have construed the Oklahoma law.

The constitutionality of the Oklahoma law was raised in the Shaffer case in which the enforcement of the tax assessed was sought to be restricted on the ground of invalidity of the statute. The plaintiff, a non-resident, was operating several oil and gas leases in Oklahoma. He contended that the state was without jurisdiction to levy an income tax upon non-residents and that the lien imposed by the law upon the entire property violated the due process clause, both of which contentions were decided against him. He further contended that the gross production tax levied in lieu of all other taxes included the income tax. As to that the court held that this tax was a substitute for the ad valorem tax only and not for the income tax. The income tax law was not repeated by implication by the enactment of the gross production law and double taxation was not violative of the 14th amendment, if it existed.\(^{200}\)

The question has arisen whether the state had power under the income tax law of 1915 to levy an income tax upon incomes derived from lessee's private personal share of oil and gas produced under departmental leases upon restricted Indian lands, and the power was upheld by the state court.\(^{201}\) But the case was reversed by the U. S. Supreme Court which held that the net income derived by a lessee from sales of his share of oil and gas received under leases of restricted Indian lands, which constituted him in effect an instrumentality used by the U. S. in fulfilling its duties to the Indians, cannot be taxed by the state.\(^{202}\) But the lessee of an oil and gas lease of restricted Indian lands is not exempt from federal income tax, although the power is withheld from the states in absence of congressional

\(^{200}\) Shaffer v. Carter, 252 U. S. 37.
\(^{201}\) State v. Gillespie, 81 Okla. 103.
TAXATION OF OIL AND GAS INTERESTS

assent.\textsuperscript{203} And the Treasury Department has always collected income taxes from leases of Indian oil lands, a practice with which Congress never interfered. And the lessee's income from the sale of oil and gas produced under leases from the State of Texas is subject to federal income tax.\textsuperscript{203*}

On lands that have proved to be oil producing leases are often made or assigned for very substantial cash considerations in addition to the regular reserved royalties. These cash considerations, denominated "bonuses," have been held subject to the state income tax in Oklahoma.\textsuperscript{204} In the Rector case it was contended that the bonus of $300,000 was not income but was a conversion of capital not taxable within the act, but the court overruled the contention. In the McCauley case the bonus paid for a lease on already producing oil property, amounting to $130,000 was held to constitute income to the land owner and taxable under the law of 1915. The same contention, that it was a conversion of capital which was not taxable as income, was made and overruled.

Section 6 of the law of 1915 provides that in computing the net income there shall be allowed as deductions from the income of any person "a reasonable allowance for exhaustion, . . . not to exceed in the case of mines, five per cent of the gross value at the mine . . . ; Provided, that no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate." In a case construing this statute with respect to a return of net income arising under an oil lease, it was first held that an oil and gas well is not a mine so that the taxpayer was not limited in his deduction to five per cent of the gross value of the production of his oil and gas wells for the taxable year, but he was entitled to a reasonable allowance for exhaustion which was a question of fact. That allowance he was entitled to have ascertained under the "unit of production" method. Under it the total amount of the recoverable oil in the property is determined, as nearly as possible, and to each barrel of this oil is assigned its part of the capital investment, and as that barrel of oil is produced and sold, from the sale price

\textsuperscript{203} Heiner v. Colonial Trust Co., 48 S. Ct. 65.
\textsuperscript{203*} Group No. 1 Oil Corp. v. Bass, 51 S. Ct. 432.
\textsuperscript{204} Carter v. Rector, 88 Okla. 12; Carter v. McCauley, 97 Okla. 255.
received therefor is taken first, the expense of producing it, and second, its proportion of the capital investment, leaving the balance as profit. Secondly, the cost of the actual drilling, such as labor, fuel and the like, as charged as expense, and the cost of derricks, casing, tubing, rods and other equipment was added to the capital account, and depreciated by taking the total cost of equipment, less any salvage value, and distributing this to the entire recoverable oil and each barrel of oil made to pay its proportionate part. Third, derricks, casing and other oil well equipment are not permanent improvements or betterments made to increase the value of the property, within the proviso, but are merely temporary equipment used only for the purpose of producing oil or gas, and may therefore, be charged to the capital account. Fourth, under the law of 1915 the income of the husband and wife and each child under 18 should be added together and one joint return made and the exemption provided for the head of the family and dependents should be allowed. And if the wife sells property to the husband resulting in income, that income should be added to the income of the husband. And income derived from departmental leases should not be included in taxable income.205

We have already seen that California allows for the depletion of oil and gas wells.206 California has adopted the provision of the federal revenue act of 1926 governing depletion. Depletion has been defined as "the return of capital invested in natural resources; through the gradual exhaustion of the quantity or units in the ground." The Treasury Department defines it thus: "Depletion is the loss sustained through the progressive removal of natural resources, as of mineral deposits."207 The Revenue Act of 1926, Sec. 204(11)(c)(2) contains the provision: "In the case of oil and gas wells the allowance for depletion shall be 271/2 per cent of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance

206 Note 6, supra.
be less than it would be if computed without reference to this paragraph."

Losses of oil and gas may arise from either unforeseen or unavoidable causes, as fire or accident; or from causes that are anticipated but unavoidable under operating conditions, as evaporation, leakage, and refinery losses. The latter are indeterminate as to amount, and are taken care of in cost or operating expenses. Indeterminate losses of oil and gas may not be deducted from gross income for income tax.\textsuperscript{208}

North Dakota statute of 1919 required that in determining the income tax due to the state from foreign oil corporations all property used by the corporation in manufacturing and refining should be included. Under this statute the Tax Commissioner in making a reassessment of the state income tax used the proportion of business done within the state to that done without the state as a ratio of allocation. Only property within the state was that used in sales and distribution of products. Profits from manufacturing and refining not done in North Dakota were thus included. This was held to be error. Theories of allocation have no place in determining income tax on a corporation, if the net income within the state can be distinguished from other business. Since profits within state were known there was no occasion to employ proportional allocation of state business with the entire business of the corporation and the reassessment tax was, therefore, void.\textsuperscript{209}

Where an oil company purchased oil leases and thereafter sold them at a profit, part of which was paid in cash and the balance to be paid in deferred payments out of the proceeds of oil, the company is not subject to an additionally assessed income tax on the unpaid part which was only promised to be paid but not in fact paid.\textsuperscript{210}

It has been held that a stock dividend is not taxable as income under the 16th Amendment.\textsuperscript{211} But where the stockholders of corporations engaged in producing, buying and selling petroleum and in transporting it through its pipe lines,

\textsuperscript{207} For discussion of depreciation and depletion under the earlier revenue acts, see, \textit{U. S. v. Ludey}, 274 U. S. 295.
\textsuperscript{208} 11 A. L. R. 508.
\textsuperscript{209} \textit{Fisher v. Standard Oil Co.}, 12 F. (2d) 744.
\textsuperscript{210} \textit{U. S. v. Christine Oil & Gas Co.}, 269 Fed. 458.
\textsuperscript{211} \textit{Eisner v. Macomber}, 252 U. S. 189.
formed new corporations to which the pipe line properties were conveyed by the oil corporations and all the capital stock in the new corporations was distributed among the stockholders of the oil corporations, pro rata, the shares so received by the stockholders were held to be dividends within the Act of 1913 and taxable income within the 16th Amendment.\footnote{212} That is, the application of the Macomber case has been restricted to cases where the corporation issues a stock dividend to its own stockholders. Such stock dividend is not income within the 16th Amendment and taxable as such. But where a corporation conveys its stock in the first instance to another corporation, or to a holding company, and the stock is conveyed back to the stockholders of the original corporation it becomes taxable as income, if it was divided out of surplus of earnings. In the Rockefeller case the capital of the old corporation remained unimpaired and the stock conveyed to the pipe line company was from surplus and thus constituted a dividend.

Under the Revenue Act of 1918, "the term 'corporation' includes associations, joint stock companies, and insurance companies." Plaintiff, an unincorporated joint stock association, sued to recover income tax paid under protest and complains of being classified as a corporation for purposes of income tax. It was held that unincorporated joint stock associations though partnerships under the Texas law, are corporations within the definition of the Revenue Act of 1918, and are subject, like corporations, to the income and excess profits taxes imposed by that act.\footnote{212*}

A much more extensive application of the income tax could be made in the oil producing states. The need, however, of placing the oil industry on the production tax basis is more imperative. The two forms of taxes are not objectionable as double taxation any more than an income tax with a property tax. Both on income tax as well as a production tax are scientific in that income forms the basis of taxation and both therefore conform to Adam Smith's first canon on taxation. Both can be accurately administered and operates justly with respect to both state and taxpayer.

\footnote{212*} Burke-Waggoner Asso. v. Hopkins, 269 U. S. 110.
Article I, Section 10, paragraph 2, of the United States Constitution provides that "no State shall without the consent of Congress lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws." It has been held that "imports" within the Constitution refers only to goods brought from a foreign country and not to goods from another state. No intention existed to prohibit by this clause the right of one state to tax articles brought into it from another. But under the commerce clause it is held that a state inspection fee levied upon goods in interstate commerce, if in fact a tax and disproportionate to the cost of inspection, imposes an unconstitutional burden on interstate commerce and is, therefore, invalid.

The Tennessee statute imposing an inspection fee of 25 cents per barrel on oil destined for sale in other states and sustained in the Crain case has already been noted, and that the Crain case is probably no longer to be considered as authoritative since the decision in Carson Petroleum Co. v. Vial was also mentioned. It has been held that oils intended for shipment outside of the state, and held at a storage depot within the state, having come to rest within the state, are subject to state inspection and tax, the same as oils for local distribution and sale. And that oils shipped to a depot outside the state, for distribution within the state, and coming to rest and inspected and taxed at that point, cannot be again taxed on reshipment into the state in the original containers. And oil products intended for the distributor's own use may be taxed by the state. This case but recognizes the principle that when an inspection fee becomes a tax it cannot be imposed on oils in interstate commerce unless the transit is ended by the goods coming to rest. When at rest and mingled with the property of the state they are taxable although then intended for interstate commerce. They have not yet actually entered into the channel of interstate commerce and until then the immunity from state taxation does not attach.

214 Woodruff v. Parkan, 8 Wall. 123.
215 Note 109, supra.
216 Note 111, supra.
217 Union Oil Co. of Calif. v. State, 125 Wash. 327.
A South Dakota statute relating to petroleum inspection and imposing a fee of five cents per barrel for inspection, regardless of quantity, and requiring that all petroleum products be inspected before they are sold in the state was upheld. The case was affirmed in a memorandum opinion by the U. S. Supreme Court. This case is sustainable on the ground that the inspection fee is so small that it is only sufficient to cover the costs of the inspection service, and would be upheld regardless of whether the oil was still in interstate commerce or in the original containers before sale.

A Georgia statute of 1890 provided for inspection of kerosene and petroleum products and fixed a fee of one-half cent per gallon for lots exceeding 400 gallons and larger fees for smaller lots, with monthly payments into the treasury of all sums in excess of $100 per month which the inspectors could retain as compensation. The charge for inspecting a tank car was $40, of which the inspector could retain $10 for services and the rest was paid into the treasury. It was held that this was a revenue statute, as the fees largely exceeded the costs of inspection, and that the statute was unenforceable as against importations intended to be sold in original packages and so sold. But that as to importations indefinitely stored within the state, or resold there after breaking the original packages, it was held that they were subject to both the inspection and the tax imposed as soon as the interstate transportation was ended. The case was affirmed by the Supreme Court. It is thus clear that whether an inspection fee is valid or not valid depends upon whether the amount of the fee is commensurate with the costs of inspection. If it exceeds that so as to constitute a tax it is invalid when imposed upon goods in interstate commerce and before they have been sold in the original package.

While gasoline taxes exist now in every state, as we believe, no attempt will be made to consider the statute of the various states. Only the decisions that have arisen in the oil states, and where they have been reviewed by the U. S. Supreme Court, will be noticed, and the statutory provisions only incidentally.

21 *Peterson Oil Co. v. Frary*, 46 S. D. 258.
22 Same case, 264 U. S. 570.
A more extensive treatment dealing with the several states will be found elsewhere.\textsuperscript{221}

Mississippi has a statute providing that "any person engaged in the business of distributing gasoline, or retail dealer in gasoline, shall pay for the privilege of engaging in such business an excise tax of 4 cents per gallon upon the sale of gasoline." The oil company sold gasoline to the United States and did not include the amount of the tax in the price charged. In a suit by the State for the tax it was held in the State court that the federal government was not entitled to buy gasoline to operate its instrumentalities without payment of the tax charged gasoline dealers, since the tax was a privilege tax measured by the number of gallons sold, and did not constitute a direct tax against instrumentalities of the federal government.\textsuperscript{222} The case was reversed, however, by the U. S. Supreme Court, holding that the dealer was not liable for the tax on that sold to the U. S. That the exactions demanded infringe its rights to have the constitutional independence of the U. S. in respect to such purchases remain untrammeled. Four Justices dissent in which Holmes, commenting on Marshall's dictum that "the power to tax involves the power to destroy," uses the expression, which is destined to acquire no less fame, that "the power to tax is not the power to destroy while this court sits."\textsuperscript{223}

The Texas court arrived at the same conclusion as the Mississippi Court and held that an occupation tax of one cent a gallon on gasoline sold and imposed on dealers in gasoline, was not, as to sales made to the federal government, a tax on it or any agency or instrumentality thereof. The fact that the company was engaged in the production and sale of gasoline and sold gasoline to the U. S. did not make it an instrumentality of the U. S. so as not to be subject to tax of one cent per gallon sold.\textsuperscript{224} The case was reversed in a memorandum opinion on the authority of \textit{Panhandle Oil Co. v. Mississippi}.\textsuperscript{225} In a suit to recover the gasoline tax of one cent a gallon of gasoline sold within the state and imposed by the statute of 1923, it was held

\textsuperscript{221} The Gasoline Tax, Benjamin Wham, 21 Ill. Law Rev. 771 (1927).
\textsuperscript{222} \textit{Miss. v. Panhandle Oil Co.} (Miss.), 112 So. 584.
\textsuperscript{223} \textit{Panhandle Oil Co. v. Miss.}, 277 U. S. 218.
\textsuperscript{225} \textit{Grayburg Oil Co. v. Texas}, 278 U. S. 582. Note 223, supra.
that the statute was not void for inequality because made applicable to intrastate commerce only.\textsuperscript{226}

The Arkansas Statute of 1921 provided for the collection of a tax upon the sale of gasoline and petroleum products to be used by motor cars of one cent per gallon to be collected by the seller from the purchaser. It was held not to be a property tax, but a tax upon the privilege of using automobiles upon the highways, and, therefore, not violative of the uniformity clause in the state constitution. The statute was upheld and construed as requiring sellers to collect and pay the tax only on such gasoline as they had reason to believe the purchasers from them would use in motors on the highways.\textsuperscript{227} Retailers were required to register and to report and pay monthly the taxes on sales made and collected by them. Suit was brought in the federal court to enjoin the enforcement of this tax. It was set forth that the complainant sold a large quantity of gasoline of which 75 per cent was used for motor cars and that it was at an expense of $600 annually in preparing and filing reports and in collecting and remitting the tax, but the court dismissed the bill, stating that the tax is not leveled against the purchaser and that he is required to do nothing under the act. The duty to pay the tax as well as the penalties are imposed upon the seller and he is allowed to reimburse himself by enhancing the price of gasoline by the amount of the tax.\textsuperscript{228} The statute does not undertake to fix the price at which he may sell. The seller is liable for the tax whether he collects it from the purchaser or not. The case was affirmed. The court holding that the retailer's rights were not violated under the due process clause of the 14th Amendment.\textsuperscript{229} In 1923 the statute was amended by imposing gasoline taxes upon manufacturers and wholesale dealers. It was held to have no application to a dealer who, at the time the statute was passed, held large quantities of gasoline in storage tanks which had been previously refined in the State.\textsuperscript{230}

The New Mexico statute of 1919 imposed an excise tax of two cents for each gallon of gasoline sold and used, and an annual license tax of $50 for each distributing station or place

\textsuperscript{226} State v. Pioneer Oil & Refining Co. (Tex.), 292 S. W. 869. Case also in 273 S. W. 615.
\textsuperscript{227} Standard Oil Co. of La. v. Brodie, 153 Ark. 114.
\textsuperscript{228} Pierce Oil Corp. v. Hopkins, 282 Fed. 253.
\textsuperscript{229} Pierce Oil Corp. v. Hopkins, 264 U. S. 137.
\textsuperscript{230} Gay Oil Co. v. State, 170 Ark. 587.
of business. In a suit by a distributor of and dealer in gasoline and petroleum products it was shown that the sale of gasoline from broken packages constituted 95 per cent and that in original packages or tank cars 5 per cent of the business. The U. S. District Court ruled that the entire statute was void as it was not separable and, therefore, void both as to interstate and domestic business. Reversing this on appeal the Supreme Court held that the $50 license tax was void in whole since as to that the statute was inseparable. And gasoline sold in original packages brought into the state could not be taxed, but the excise tax of two cents was valid as to all gasoline sold in the state not in original containers.231

The Colorado statute of 1919 imposed a tax upon gasoline sold or used for motor vehicles to be used for the maintenance of roads. The tax was not levied upon other users of gasoline. The court held the act valid and that the classification was reasonable and clearly defined. And being an excise tax it did not violate the constitutional provision that all taxes shall be uniform upon the same class of subjects.232 The case was dismissed for want of jurisdiction in a memorandum opinion by the Supreme Court.233 The Washington gasoline tax of two cents per gallon for gasoline for use in motor vehicles operated upon the public highways in the state was held not a "toll" forbidden by Federal Highway Act.234 The Arizona statutes of 1921 and 1923 imposing a gasoline tax and providing that it should be collected by the dealer and added to the sale price of the dealer of gasoline sold for use in motor vehicles was held to be a tax on the purchaser, contrary to the holding by the federal court under a like statute from Arkansas.235 That would seem to be just a distinction in words. The incidence of the tax is intended to be borne by the consumer in both cases, while the state only looks to the dealer for the payment of the tax. The consumer is not liable to the state for the tax and if the dealer fails to collect it from the purchaser that does not affect the dealer’s liability for the tax.

232 Attitude Oil Co. v. People, 70 Colo. 452.
233 Same case, 260 U. S. 693.
235 Texas Co. v. State (Ariz.), 254 Pac. 1060. Note 228, supra.
The Montana statute of 1923 imposed a two cent per gallon license tax on distributors and dealers in gasoline refined and manufactured in Montana, but the tax did not apply to gasoline shipped into the state and sold in the original packages. The court held that the statute discriminated against Montana manufactured gasoline. The place of origin was the sole basis of classification. The statute was, therefore, void as an arbitrary discrimination against Montana refined gasoline.236

Louisiana constitution of 1921, Section 21 of Article 10, authorized the legislature to levy, and to provide for the collection of, a tax, not to exceed two cents per gallon on gasoline sold within the state. The statute enacted in 1921, Act No. 81, purporting to be in pursuance of this authority levied a license tax on dealers, already subjected to another license tax, and without providing that the tax be collected from the consumers. It was held that the intent of the constitution was to place the burden of the tax on the consumer who had the benefit of the roads, and that the statute was invalid. The constitution, contemplating that the burden of the tax should be placed on the ultimate consumer, operated as a restriction on the power of the legislature to impose any other tax.237

The Kansas statute of 1925 imposed a tax on the sale or use of gasoline for motor vehicles and provided "'that the tax . . . shall be in lieu of all other taxes or license fees (except occupation taxes) upon the sale or use of said motor vehicle fuels.'" A city by ordinance fixed an occupation license fee on certain trades, occupations and businesses in the city. On each filling station where one gasoline pump was used, $360; where two pumps were used double that amount; and where no pumps were used, but other means were employed for dispensing gasoline, $360, all in annual license fees. It was held that the ordinance was void. The charge was a license fee rather than an occupation tax and in conflict with the statute of 1925.238

A city imposed a license tax on corporations which sold oil in the city, but placed a greater license tax on the ones which brought in the oil in bulk, tank cars, or through pipes, than on the ones which brought in the oil in barrels only. It was held that the ordinance discriminated between members of the same

236 State v. Sunburst Ref. Co., 73 Mont. 68.
class, laying a greater burden on one than on another, and violated the constitutional requirement of uniformity. But an ordinance which imposes one rate of taxation on those who sell oil from tank wagons or barrels transported through the streets of a city, and another and lower rate on those who sell in a different way, is valid. Here the classification is valid. The difference in the manner of distribution is a reasonable classification, as one imposes a greater burden on the streets, and is more hazardous than the other.\textsuperscript{239}

The motor car gasoline tax is the one country-wide excise tax. Its popularity with tax administrators is due to the fact that it is an effective revenue producer and offers no difficulties in the way of administration. It is practically self-executing. The motorists have not complained because the proceeds have usually, if not in every instance, been devoted to the construction and maintenance of highways. In some states the tax has already reach the high rate of five cents per gallon and rates of three or four cents are common. The rates have constantly been increased, starting with a modest beginning of one cent per gallon. This would lead one to reflect if the limit has not almost been reached in states that now impose the highest rates. The motorists are so numerous that they might offer effective opposition to further increase in rates should they desire to do so. Extensive highway construction programs, such as that recently completed or under way in Iowa financed by long term bonds, are expected to be paid for largely out of revenues derived from the gasoline taxes. With the completion of construction programs the motorist may well hope that the gasoline tax should not be much increased in the future. Should the law seek to divert this source of revenue to other forms of expenditures more opposition to the tax would no doubt arise.

VII.

Under a production tax the method of assessment of taxes is to require monthly or quarterly reports to be filed by the lessee with the assessing authority showing the amount of oil produced during the preceding period. In states applying the property tax, the valuations, as we have seen, are often computed in terms of production. Thus it is common to take the

\textsuperscript{239} Standard Oil Co. v. Fredericksburg, 105 Va. 82.
average daily production on January 1, or on tax day, and multiply that production in barrels by the price that a barrel of that production could be sold for in the market. This method ordinarily gives a higher assessment per barrel for royalty oil than for the oil produced by the lessee’s working interest. Where the royalty interest may be valued at $10.00 per barrel the lessee’s interest have been valued at only $4.50 per barrel in the same instance. This method was used in Louisiana before the present severance tax was adopted. The rule, employed by the assessors for computing the oil producing value of the land, was multiply the number of barrels of settled production on the 1st day of January by the current selling price or market value per barrel of such production, based on its gravity and the probable life of the particular field where the production is situated. This selling price might be $10.00 per barrel or less.

A method that has been used in California consisted in taking the total production for the taxable year and reducing that to a net income basis. Then capitalize this at ten per cent of which 40 per cent was taken as the assessed valuation. Other California assessors have used methods for ascertaining the value of oil leases for which no rational basis can be found.

We have seen the application of the “unit of production” rule in Oklahoma for the purposes of determining depletion allowed from the gross production of oil and gas for the purposes of determining the net income taxable under the state income tax. In that state previous to the gross production tax law the oil companies made a return of their property for the purposes of taxation to the state auditor. After this was equalized by the state board of equalization the valuation was certified by the state auditor to the various county assessors where the taxable property was located. After the assessment had been so certified the state board was without power to reassess the property on the ground that omitted property had been discovered. Omitted property could not be added until a subsequent year.

\[\text{Note 130, supra.}\]
\[\text{Note 66, supra.}\]
\[\text{Shaw v. Watson, 151 La. 893.}\]
\[\text{Note 191, supra.}\]
\[\text{Note 205, supra.}\]
\[\text{Prairie Oil & Gas Co. v. Grue, 45 Okla. 774.}\]
New Mexico at the present time.\textsuperscript{246} The gross production tax in Oklahoma provides an exclusive method of taxation of the minerals beneath the surface of the land. Land is separately assessable and taxable, but in determining its value for taxation purposes, the mineral contents actual or prospective, are to be disregarded. Thus where land was returned at $250 for the entire tract and the assessor increased the assessment to $18,000 because of the mineral value in the land the assessment was not sustained.\textsuperscript{247}

Where the wells produced oil and gas, and where the gas yielded $100, it was valued the same as if 50 barrels of oil had been produced.\textsuperscript{248} In Indiana where oil wells are to be considered in fixing the value of the land an assessment was increased by reason of such wells. The increase was not allocated to any particular piece of land but was added to the sum of the valuations of complainant's lands. The total value of the lands were increased because of oil producing wells on some of the tracts and the tax was upheld.\textsuperscript{249} The method of assessment in Kentucky has already been considered.\textsuperscript{250} In Louisiana the land owner was required to return the land for assessment together with the mineral value. The land was returned for agricultural purposes only. The board of review adjourned to allow the assessor time to obtain information to assess the minerals. The assessment of the minerals was then added to the land at a reconvened meeting of the board without notice to the owner. The assessment was upheld and the owner having failed to make the return was held estopped from contesting the correctness of the assessment made by the assessor.\textsuperscript{251}

Lessee was developing two contiguous tracts for oil and gas owned by different owners. On one a large loss was sustained, while the other produced a large profit. In his return for the net proceeds tax he claimed the right to deduct the losses sustained on the one from the profits on the other, on the ground that they were operated as a "mine" which the Montana laws allowed to be developed as a unit when there were two or more

\textsuperscript{246} Notes 18, 19; 31, 32, supra.
\textsuperscript{247} Kenoyer \textit{v. Bd. of Equalization}, 130 Okla. 3.
\textsuperscript{248} Cobb \textit{v. Downing} (Tex.), 1 S. W. (2d) 508.
\textsuperscript{249} Risley \textit{v. Rumble} (Ind. App.), 144 N. E. 568.
\textsuperscript{250} Note 64a, supra.
contiguous claims. But the deduction was not allowed. The rule with respect to mines is not applicable to oil and gas where each landowner is interested in securing the maximum of his share of oil. The interests of all parties are antagonistic, due to fugacious nature of the minerals.

An Arkansas statute authorized the assessment of oil and gas leases, whether owned by individuals or corporations, but only corporations were subject to suits for back taxes. It was held that this affords no discrimination that would render the statute unconstitutional. No par value stock may by statute be assigned a value of $100 for the purpose of computing any organization taxes required to be paid by the laws of the state, and such statute is valid for the purpose of determining the amount of franchise tax on foreign corporations. In Illinois where an ordinary oil and gas lease is held to effect a severance of the estates and where the statute requires such severed estates to be separately assessed, it was contended that the entire mining right had been assessed to the lessee, contrary to the provisions of the statute. The land was taxed $14.10, and it does not appear what was the amount of lessee’s tax. The court states that it is not raised in record as to whether fee should be taxed higher by reason of the one-eighth of the oil reserved. Evidently the royalty interest was not used to increase the value of the fee.

The Standard Oil Company, an Ohio corporation, bought petroleum in Pennsylvania and refined it outside the state; it owned interest in individual partnerships doing business in Pennsylvania as producers and refiners of oil; it was the owner of stock in Pennsylvania corporations and of interests in limited partnerships doing business in Pennsylvania also as producers and refiners of oil. It was held that this did not constitute a “doing of business in this commonwealth” so as to subject the Standard Oil Company to taxation on its capital stock except as to the interest it held in the individual partnerships. On this it was taxable upon so much of the capital stock as represented the proportion which its property and assets invested in the

\[2^{52} \text{Rice Oil Co. v. Toole County (Mont.), 284 Pac. 145.} \]
\[2^{53} \text{State v. Arkansas Fuel Oil Co., 22 S. W. (2d) 556.} \]
\[2^{54} \text{State v. Pierce Petroleum Corp. (Mo.), 2 S. W. (2d) 790.} \]
\[2^{55} \text{People v. Bell, 237 Ill. 332.} \]
individual partnerships bore to its entire property and assets during such period.\textsuperscript{256}

The unit rule which allocates that part of a corporation's stock to a state in the proportion that the property within the state bears to the entire property of the corporation wherever situated is not permitted to be employed with respect to the assessment of the property of oil corporations. When the value of its property within the state is known there is no occasion to allocate values on the basis of capital stock. The unit rule may usually legitimately be employed in the case of public service companies where the allocation of capital stock may be based upon the ratio of the mileage within the state to the total mileage in all states. The rule can be used with respect to telegraph companies and perhaps with respect to pipe lines to arrive at franchise values. The property of oil companies, however, is not tied up in any such unit relation that the proportion rule can be used based upon the ratio of property. When the property value can be determined that is all that is within the jurisdiction of the state to tax. Similarly, it is usually not permissible to capitalize the net income for the purpose of arriving at valuations as a basis for taxation in the case of oil companies.

Thus taxes were sought to be enforced against an oil company the levy of which were based upon the proportion of its capital stock which was represented by its tangible property in the taxing state. The tax was held invalid, the court stating that the unit system of taxation can only be applied to public carriers and other like public corporations and that the rule is not applicable to oil refining companies or those engaged in drilling for oil. There is no organic relation between plants and refineries of oil corporations situated in different states, and there can be no connected use of such plants authorizing a tax levied on capital stock. A statute authorizing a tax on tangible property of all corporations is not applicable to foreign corporations with respect to property outside the state. The capital stock of such corporation is property permanently beyond the state borders and precludes the state from taxing it.\textsuperscript{257} And it was held that the Arizona statute providing for the application of the unit rule to private car lines, railroad property, telegraph

\textsuperscript{256} Com. v. Standard Oil Co., 101 Pa. 119.
\textsuperscript{257} State v. Lion Oil Ref. Co. (Ark.), 284 S. W. 33.
and telephone lines, does not authorize the unit rule valuation for taxation of the property of foreign oil companies.\textsuperscript{258} We have seen that a state income tax cannot be computed by using the proportion of business done within the state to that done without the state as a ratio of allocation if the net income within the state can be distinguished from other business.\textsuperscript{259}

In a suit to enjoin the collection of an excess tax where the capitalization method had been used it appeared that the total value of the property was $191,855 which should have been assessed on the basis of 50 per cent as other property. The tax commission applied the capitalization of net earnings at six per cent by which it valued the property at $439,592. It was held that the commission cannot fix the valuation of natural gas property by ascertaining the net earnings of the company and then fix an amount as valuation which would produce the net earnings at six per cent. The commission should take into consideration the net income of the property as affecting its value, but should also consider the probable producing life of the gas wells, the increased cost of developing them and the percentage of the capitalization of the concern included in the net income. Taking the net income alone of property as basis of valuation is fundamentally wrong.\textsuperscript{260} In another case the county assessing authorities had assessed the oil company’s property at its full cash value of $342,706 which was all property in the state and included real estate, motor trucks and sales stations in the various counties. The Arizona state board of equalization determined its net profits on sales in the state for the year in question which it capitalized at 25 per cent resulting in a valuation of $2,910,600. The company was granted an injunction. The statute of Arizona required the assessment of all taxable property at its full cash value which the state board could not ignore and tax its intangible property by the capitalization method fixed upon earnings generally without regard to specific items of its property. The statute conferred no authority to tax earnings, and intangible property included only franchises, credits, and choses in action.\textsuperscript{261} In a California case the capitalization of ten per cent based on net income deduced by

\textsuperscript{258} Standard Oil Co. of Calif v. Howe, 257 Fed. 48.
\textsuperscript{259} Note 259, supra.
\textsuperscript{260} Martineau v. Clear Creek Oil & Gas Co., 141 Ark. 596.
\textsuperscript{261} Note 258, supra.
the assessor was upheld as a basis for finding the value of an oil lease. But it did not appear that the statute directed that any other method be pursued. Duty to assess the oil leases was enjoined upon the assessor and he sought to determine that value by using production as a basis. The court stated that it was limited in its investigation only to ascertain that the valuation was not fraudulent.

The value of capital stock may be ascertained by either of three methods: the stock and bond, the capital plus surplus, and the capitalization of net income methods. In arriving at the value of the franchise under the Kentucky statute the value of the capital stock is first determined. From this the assessed value of the tangible property of the corporation is deducted. The remainder represents the franchise value. In a suit to restrain the enforcement of a franchise tax it appeared that the value of the capital stock had been determined by the capitalization of net income method. The average net income was taken from the incomes of the three preceding years. This was capitalized at seven per cent and the value of the tangible property deducted. The court, however, holds that the method of arriving at the franchise value was wrong as only the net income in the past was considered by the commission, whereas the probable net income which would accrue to the company in the future must be considered in arriving at the value of the franchise. This was a domestic pipe line corporation whose business and line were confined entirely to Kentucky. The court then proceeds to estimate the net income each year for a period of 20 years in the future from the year in question on a decreasing return basis. The present worth of this aggregate income, plus non-taxable securities and other quick assets gives a total value for all its property of $4,408,000. By the use of the stock and bond method the total property value is found to be $4,500,000 substantially checking. From this value the non-taxable securities and the assessed value of the tangible property are deducted leaving $1,229,000 for franchise value, whereas the franchise value found by the commission was $5,484,000 where it capitalized the average net income of the past only. Upon this value the tax is allowed. The case was not appealed. The income

Note 66, supra.

Cumberland Pipe Line Co. v. Lewis, 17 F. (2d) 167.
of a pipe line that only serves a single oil field will obviously
diminish each year after the field is fully developed until the
income will ultimately approach zero as a limit. Therefore, in
assessing the value of a franchise this future diminution of
income should be taken into account.

The courts are disinclined to grant injunctive relief to
restrain the collection of taxes on the ground of interference
with the due administration of government. Thus where taxes
are illegal in part an injunction will not be granted unless the
legal part is tendered. And where the statute provides for the
payment of disputed taxes under protest and suit for recovery
the remedy at law is considered adequate so injunctive relief
will not be given. And where the law provides for administra-
tive appeals those must be pursued before any relief can be had
in the courts unless the time for such appeals has expired
without fault of the complaining party. But where no juris-
diction to tax exists injunction is always a proper remedy to
restrain the collection or levy of an illegal tax. Ordinarily there
can be no recovery when illegal taxes are voluntarily paid.

Thus a mere mistake in judgment in valuation by taxing
boards or commissions from which no appeal lies, cannot be
relieved in equity, but it will restrain illegal taxes assessed by
such boards, induced by fraud, gross mistake, discrimination,
non-uniformity or the adoption of fundamentally wrong
methods.\(^2\)\(^6\)\(^4\) And where it was sought to restrain the collection
of back taxes on omitted property and a remedy by appeal to the
county court was given from the final action in imposing such
taxes it was held that the court has no jurisdiction to give
equitable relief where a party had not availed himself of the
administrative remedy provided for by statute. Such adminis-
trative remedy is exclusive.\(^2\)\(^6\)\(^5\) But injunction is a proper
remedy against the collection of a tax on property not subject
thereto.\(^2\)\(^6\)\(^6\) And where a franchise tax is levied under a repealed
statute it is void and its collection will be enjoined. The statute
under which the tax was levied required the levy of the franchise
tax on the proportion of the capital stock of the corporation as
represented by its "property and business" in the state. The

\(^{2}\)\(^6\) Note 260, supra.
\(^{2}\)\(^6\)\(^4\) Busey v. Prehistoric Oil & Gas Co., 79 Okla. 121; same in Perry
v. Carson, 61 Okla. 263.
\(^{2}\)\(^6\)\(^5\) St. Mary's Gas Co. v. Elk County (Pa.) 43 Atl. 321.
law in force requires the levy of the franchise tax upon the proportion of the subscribed capital stock of the corporation represented by "property owned and used in business" transacted in the state. The tax under the statute in force was very much smaller and the court enjoins the collection in excess of what the amount should be under the statute in force. Where there is no statute authorizing a recovery, gasoline taxes voluntarily paid under an unconstitutional statute cannot be recovered. And for the further reason that these taxes had been collected from the consumers of motor car fuel and cannot be returned to them should the tax be refunded.

We have seen that where the landowner failed to make a return of the mineral estate for assessment he was estopped from contesting the correctness of the assessment made by the assessor and was not entitled to insist upon notice of the reconvening of the board of review. And where a severance tax had been collected under the old law and an increased severance tax is collected under the new law for the same period the taxpayer is entitled to have the tax paid under the old law credited upon the amount subsequently collected after the tax rate had been increased. An injunction was sought to prevent the levying and collection of the proportionate share of the gross production tax upon a royalty share of oil produced from restricted Indian lands which were non-taxable. The statute authorized the withholding of royalty by the lessee until the tax was paid. The suit was dismissed since the statute provided for the payment of taxes under protest and an action to recover the same, which furnished an adequate remedy at law and is exclusive. Therefore, the court did not pass upon the validity of the tax. The Supreme Court dismissed the case for want of jurisdiction since the state court disposed of it on the ground that the complainant had a plain, adequate and exclusive remedy at law by paying the tax under protest and suing for its recovery, and did not consider the federal question whether the plaintiff was exempt from the tax. The court states the rule that a judgment of a state court which is put upon a non-federal

---

268 Richardson Lubricating Co. v. Kinney, 337 Ill. 122.
269 Note 251, supra.
271 McCoy v. Childers, 124 Okla. 256.
ground, independent of the federal question involved and broad enough to sustain the judgment, cannot be reviewed by the Supreme Court, unless the non-federal ground is so plainly unfounded that it may be regarded as essentially arbitrary or a mere device to prevent the review of a decision upon the federal question. Since the state court based its decision upon an earlier state decision the non-federal ground was sufficient to sustain the decision and no intent to evade the federal question is indicated.\(^{272}\)

Section 280 of the Revenue Act of 1926 purports to empower the Commissioner of Internal Revenue to determine the liability at law or in equity of a transferee of property of a taxpayer. It was held that the statute was unconstitutional as the transferee is entitled to his day in court before he can be made liable for the tax of another. The statute attempts to confer judicial power upon the commissioner and is void. When the government undertakes to collect this liability from a third party against whom it was not originally assessed, the liability must rest upon contract, either express or implied. And the Revenue Act of 1928 which provides that "'no suit shall be maintained in any court for the purpose of restraining the assessment, or collection of the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any income, war-profits, excess profits or estate tax . . . .'" is likewise void, as withdrawal of remedy falls with the unconstitutional statute.\(^{237}\)

VIII.

A few cases that do not readily admit at classification may be grouped under a miscellaneous heading. Thus where the lessor executed an oil and gas lease reserving the usual royalty and in the further consideration of a bonus part of which was payable out of the oil to be produced the lessee could not under the severance tax statute retain the tax on this fraction of the oil that was security for the unpaid part of the bonus. Deferred payments to be made from the production of oil and gas is not such an interest as would be chargeable with the severance tax. The statute of 1923 provided that a "'tax shall be required of

\(^{272}\) *McCoy v. Shaw*, 48 S. Ct. 519.

\(^{237}\) *Mid-Continental Petroleum Corp. v. Alexander*, 35 F. (2d) 43.
the severed or produced actually engaged in the operation of severing natural products whether as owner or lessee.” Since the lessor is not engaged in severing the product he is not liable for the tax though a part of the consideration was payable out of seven-sixteenths of the first oil and gas produced. The pipeline companies and refineries receiving oil were made collectors of the severance tax under the statute.

The tax ferret law of 1921 in Oklahoma has been held to apply only to property omitted from assessment, and it does not confer power or authority to revalue or reassess property which has already been assessed. Thus where one company owns refined oils stored in tanks on and in the possession of another company, and the latter company renders such property for taxation in its own name and pays taxes thereon, such property may not thereafter be entered upon the tax rolls as omitted property.

We have seen that the gross production tax in Oklahoma is in lieu of the ad valorem tax on the leases and on the equipment immediately devoted to the production of oil. The question arose whether certain houses built by the operator of an oil lease for housing his employees are a necessary part of the equipment of a producing oil lease so as to come within the exemption. It was held that this is one of fact to be determined by the court under the circumstances of each particular case.

The Louisiana constitution of 1898, Article 230, provided that “there shall also be exempt from parochial and municipal taxes for a term of ten years from the 1st day of January, 1900, the capital, machinery, and other property employed in mining operations.” The question arose whether that exempted oil wells from taxation. Oil in Louisiana was unknown at the time of the adoption of this constitutional provision and the court holds that the term “oil well” is not included within mining operations and does not come within the exemption from taxation. Laws granting exemptions from taxation must be strictly construed, and so the operation of an oil well cannot be held to be within the exemption granted to those engaged in mining operations.

A filling station on leased land which the lessee was

---

275 Payne County v. Empire Petroleum Co., 104 Okla. 42.
276 Josey Oil Co. v. Bd. of Comrs., 107 Okla. 236.
277 J. M. Guffey Petroleum Co. v. Murrel, 127 La. 466.
privileged to remove is taxable as personal property.\(^{278}\) A Kentucky statute imposing a tax of $10.00 on oil depots wherein petroleum or other oils are stored in bulk or tank is invalid as a property tax under the constitutional provision which requires taxes to be uniform and property to be assessed at its fair cash value, and taxed in proportion to value. Nor is it valid as a license tax if the subject of the license is construed to be the oil depot or building. The tax of $10.00 imposed on each depot in state where petroleum is stored in bulk or tank is to be construed as a police regulation and is valid as an incident of regulation because of the dangerous character of oil. But where the appellant maintained a warehouse in which it kept oil stored in barrels in about car lots and the statute did not purport to tax merchants who stored oil in barrels and small lots the appellant has the same rights as merchants and the conviction was not sustained.\(^{279}\) Oil imported in tank steamers and pumped into receiving tanks belonging to the importer, for distribution by the owner of the tanks, has lost its character as an import and becomes subject to local taxation.\(^{280}\) A Texas statute imposed an occupation tax on gas companies (including some other public service companies) at the rate of one-half per cent in cities of 25,000 population and over and one-fourth per cent in cities from 10,000 to 25,000. No occupation tax was levied in cities below 10,000. The tax was levied on the gross receipts. It was held that the statute did not violate the constitution requirement of uniformity in taxation. The classification was reasonable and not arbitrary.\(^{281}\)

IX.

The nature of the business of oil and gas production has given rise to the leasing system. Since under the ordinary oil and gas lease the lessee becomes entitled to remove the oil and gas discovered and produced in the course of exploration and development and only a small fraction is reserved by the landowner as royalty, the question has arisen, who is owner and taxable for the respective interests that each enjoys under the

\(^{278}\) Boxer v. Sears, 119 Kan. 733.  
\(^{279}\) Standard Oil Co. v. Commonwealth, 119 Ky. 75.  
\(^{280}\) Mexican Petroleum Corp. v. South Portland, 121 Me. 128.  
lease. By the great weight of authority an ordinary oil and gas lease creates a severance between the mineral and surface estates. And this notwithstanding the fugacious nature of oil and gas. The lessee thus becomes vested with ownership of his share of the mineral and the lessor retains the surface and his royalty interest. Each is then taxable upon his respective share. An ordinary agricultural lease is not taxable to the lessee while a mineral lease is. In the latter, however, the lessee removes a part of the corpus of the land which is not the case in the former.

Texas courts have taken the strongest position in support of the severance theory. In that state an ordinary oil and gas lease vests a determinable fee in the lessee to the oil and gas in place. This interest is separately taxable to the lessee. In Kentucky severance of the estate is likewise recognized, but the constitutional rule that leases shall be assessed at the fair cash value estimated at the price it would bring at a fair voluntary sale is unworkable in practice and resolves itself into a matter of opinion evidence, since leases are not sold or offered for sale at the time of assessment. Of some fifteen or more oil producing states only Ohio and Oklahoma refuse to recognize the severance doctrine and, therefore, hold that an oil and gas lease is not taxable to the lessee. The adoption of the production tax in the latter state has rendered the question unimportant there. Some states hold that a lease which purports to grant and convey the oil and gas in the land affects a severance while a lease that merely confers a right, privilege, or license to enter and explore and remove the mineral do not affect a severance of the estates. This has been the Kansas and West Virginia view. In the latter state undeveloped oil leases have not been taxable to the lessee since the decision in the South Penn Oil Co. case.

In the taxation of the respective interests of lessor and lessee the property tax prevails in nearly all states. In a few states the property tax is supplemented by a tax measured by the amount or value of the oil and gas produced. Since an oil lease is practically impossible to value for purposes of taxation because of the unknown character and quantity of the mineral the general tendency and practice is to turn the property tax into a production tax by roughly measuring the value of the output rather than valuing the lease itself. In California where
only the property tax prevails the tendency is to value the leases in terms of production. Equipment devoted to the production of oil is taxable in all states, except Oklahoma, under the ad valorem tax. Kansas like Kentucky provides for an unworkable statutory formula for valuing oil leases and the consequent attempt to base lease valuations on production. A production tax should replace the property tax in such cases.

A property tax administered on a production basis frequently takes the average daily production of a well on January 1st or tax day and multiplies the number of barrels by the price that a barrel from the well would sell for in the market. This may be $1,000 or less. The market value of the lessee’s interest will be less. The daily production times this sum will be the assessed valuation of the well or lease. Under this system a well with a declining production will be over assessed, while new wells coming in after tax day will go untaxed for the balance of the taxable year.

Pipe lines are taxable as real property and under the federal income tax transporters of their own oil must pay the same tax as if they transported oil for hire. The oil moving through the pipes in interstate commerce cannot be taxed as property. While receipts derived from transportation in interstate commerce are subject to a state income tax, a state should be permitted to tax the oil as property in passing through the pipe line. 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 have to be levied by the state and apportioned.

Oil in storage tanks used in connection with pipe lines for the interstate movement of oil is exempt from taxation to the extent that the quantity stored is necessary to keep the oil moving. Other oil in storage is taxable ad valorem. Storage tanks are taxable ad valorem, except those immediately devoted to the production of oil in Oklahoma. Tank cars are taxable like other rolling stock. In Louisiana tank cars owned by non-resident individuals and corporations that have not acquired a Louisiana domicil are subjected to the additional 25 mills state tax in lieu of all local taxes. Residents and those domiciled there are sub-
jected to local taxes and not to the 25 mills tax. It seems that to facilitate uniformity in tank car taxation in Louisiana, tank cars and rolling stock, whether owned by residents or non-residents, by domiciliaries or non-domiciliaries, should be taxed by the state tax commission alone and the tax distributed to the local subdivisions.

The unsuitability of a property tax as a means for the valuation of oil leases is demonstrated from the fact that either the property tax is turned into a production tax or leases are not taxed at all, which would follow with respect to undeveloped leases. A property tax based on production will result either in over taxation in a developed field or many have the opposite result where the field is in process of development. In West Virginia it proved to be impossible to tax oil and gas to the lessee under the property tax. The logical substitute for a property tax is a tax on the production of oil and gas and this should be in lieu of any other tax on the mineral contents in the land. While the Oklahoma gross production tax levies three per cent on the market value of all oil and gas produced, and which tax is in lieu of all other taxes on the leases and the equipment immediately devoted to the production of oil, the state board of equalization has the power on proper showing to vary the rate so as to make the tax conform in amount to the ad valorem tax for all purposes. This is the rule with respect to ordinary leases. With respect to departmental leases where it has been held that the gross production tax does not apply the equipment used in the production of oil is taxed ad valorem. Oklahoma has an approved system for the taxation of oil and gas.

The same may be said of the severance tax system in Louisiana under the 1928 law. Here the tax is upon all natural resources severed from the soil. Oil is taxed at four cents per barrel of 28 gravity and below up to eleven cents per barrel of 42 gallons for oil of 43 gravity or above. Since the price of oil in the oil industry is based upon gravity this Louisiana severance tax is based upon scientific principles. Then the tax is in lieu of all other taxes upon leaseholds, but the equipment is subject to the ad valorem tax. Arkansas has a severance tax in lieu of tax on leaseholds and equipment is taxed ad valorem like Louisiana. The Kentucky gross production tax which was in
lieu of all other taxes on wells was held not to be a substitute for the ad valorem tax on wells and leases. It is thus apparent that the Kentucky constitution must be amended before the state can have a gross production tax in lieu of all other taxes. Montana, Texas, and West Virginia are the only other states that have a production tax supplementing the ad valorem property tax. Other states should enact approved production taxes like those found in Oklahoma and Louisiana.

Oklahoma and Arkansas are the only oil producing states that have income taxes. These are levied at low rates. While income taxes at higher rates might be used in all the states to supplement the production tax, the state income tax for the oil industry is not so imperative as a production tax.

Inspection fees are validly imposed by the states under the police power to ascertain that certain standards are complied with, even with respect to oil and gas transported in interstate commerce, if the fees do not assume the proportion of a tax for revenue but are only adequate to defray the costs of the service. Taxes on gasoline for motor vehicle use is perhaps levied by every state in this country. The tax is an effective revenue producer and easy of administration, and since the proceeds are devoted to highway improvement little opposition to this tax arises from the consumer.

The unit rule in taxation which finds frequent application in the case of public service concerns is not ordinarily applicable to oil and gas production and refining and is not permitted to be used. There is no organic relation between refineries and producing fields and property of oil companies located in different states to warrant the application of the rule. The same may be said with respect to the so-called capitalization rule as applied to net income for the purpose of determining the value of leases or the capital stock for franchise taxes.

Injunction is not ordinarily a proper remedy against the collection of illegal taxes, unless there was no jurisdiction to levy the tax. The part of the tax that is legal must be tendered, and where statutes provide for the payment of taxes and suit for recovery the remedy at law is adequate, and administrative remedies for relief must first be pursued. And where taxes have been voluntarily paid no remedy for recovery exists.

Charles Gustav Hagnlund.

Cambridge, Mass.
Published four times a year by the College of Law, University of Kentucky: Issued in November, January, March, and May.

Subscription Price $2.50 Per Year........................75c Per Number

EDITORIAL BOARD

FACULTY OF THE COLLEGE OF LAW, EX OFFICIO

ROY MORELAND, Faculty Editor
JOHN BAGWELL, Student Editor
W. H. DYSARD, Managing Editor

LON ROGERS, Business Manager
EDWIN DENNY, Circulation Manager
GORDON FINLEY, Student Notes

CHARLES SUMMERS, Book Reviews and Legislation

J. D. BOND
HUGH BROADHURST
FRANCIS HANKES
KENTH HAYE

BERT HOWARD
RALPH HUMAN
JAMES HUME
JAMES LYNE

MALCOLM STRANGE
RAWLINGS RAGLAND
WALTER VEST

CONTRIBUTORS TO THIS ISSUE

Frank Murray, A. B., Univ. of Montana; LL.B. 1925, Univ. of Montana; S. J. D. 1930, Harvard Univ.; Asst. Prof. of Law, Univ. of Montana School of Law, 1928-1929; Prof. of Law, Univ. of Kentucky College of Law since 1930.

Alvin E. Evans, A. B. 1898, Cotner Univ.; A. M. 1898, Univ. of Nebraska; Ph. D. 1908; J. D. 1918, Univ. of Mich.; attended Harvard Law School, 1915-1916; Dean and Prof. of Law, Univ. of Kentucky College of Law since 1927.

Edwin F. Albertsworth, A. B. 1915, A. M. 1916, Ph. D. 1918, George Washington University; S. J. D. 1921, Harvard University; Professor of Law, Northwestern University Law School; Contributor to various legal periodicals.

H. H. Grooms, LL. B., University of Kentucky; Editor-in-Chief of the Kentucky Law Journal 1925-26; member of Phi Alpha Delta; practised law in Birmingham, Alabama, with the firm of Coleman, Cole, Spain & Stewart since June, 1926.

M. M. Chambers, B. A. 1922, Ohio Wesleyan University; M. A. 1927,