West Virginia's Generation of Electricity Tax: Is It Valid after Snead

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STUDENT NOTES

WEST VIRGINIA'S GENERATION OF ELECTRICITY TAX: IS IT VALID AFTER SNEAD?

I. INTRODUCTION

Under the West Virginia tax structure, a tax is imposed on electricity by one of two provisions of the comprehensive Business and Occupation Tax:¹ Electric power which is sold to West Virginia consumers is taxed under the public utility tax;² a second tax is imposed upon the generation of electricity within the state.³

¹ W. VA. CODE §§ 11-13-1 through 11-13-26 (1974 Replacement Vol. & Cum. Supp. 1980). The Business and Occupation Tax is a gross receipts tax imposed on persons engaged in specified activities named within the article. W. VA. CODE § 11-13-2 (Cum. Supp. 1980). A gross receipts tax is a tax on the privilege of engaging in an activity, such as generating electricity within a state. The measure of the tax is the amount of the gross receipts from the sale of the goods or services.

² W. VA. CODE § 11-13-2d (Cum. Supp. 1980) [hereinafter referred to as the public utility tax] reads in pertinent part:

Upon any person engaging or continuing within this State in any public service or utility business, . . . there is likewise hereby levied and shall be collected taxes on account of the business engaged in equal to gross income of the business multiplied by the respective rates as follows: . . . electric light and power companies, four percent on sales and demand charges for domestic purposes and commercial lighting and four percent on sales and demand charges for all other purposes, except as to income received by municipally owned plants producing or purchasing electricity and distributing same: Provided, That electric light and power companies which engage in the supplying of public service but which do not generate or produce electric power shall be taxed on the gross income derived therefrom at the rate of three percent on sales and demand charges for domestic purposes and commercial lighting and three percent on sales and demand charges for all other purposes, except as to income received by municipally owned plants: . . .

³ W. VA. CODE § 11-13-2m (Cum. Supp. 1980) [hereinafter referred to as the generation of electricity tax] reads:

(1) Upon every person engaging or continuing within this State in the business of generating or producing electric power for sale, profit or commercial use, either directly or through the activity of others, in
In 1978, the West Virginia Legislature drastically amended the Business and Occupation Tax imposed on electric utilities and generators. First, the rate of tax on electric utilities was reduced from 5.72% to 4% of gross sales. Second, the generation of electricity, which had previously been taxed at 0.88% under the broadly-based manufacturers' tax, was excepted from the new manufacturers' tax. Third, a new tax was imposed on producers or generators of electric power at the rate of 4%. Like the old generation of electricity tax imposed under the manufacturers' tax, the new tax exempts generators who are subject to the public utility tax.

Prior to the 1978 changes, electric generators who produced power within the state but transmitted it outside the state were only subject to the minimal manufacturers' tax. Clearly, these companies were not bearing their full shares of the social costs connected with the production of this energy, such as air pollution, stress on local public services, and strip-mined land. The burden of these costs, therefore, fell on the residents of West Vir-
Virginia. The new generation of electricity tax was designed to compensate for these social costs by increasing the tax revenue from electricity produced within the state. Since the generators of electricity sold to West Virginia consumers were already subject to the public utility tax and, therefore, were paying their way, electricity sold intrastate was exempted from the new tax. The effect of these changes was to spread the social costs of generating this energy over all electricity produced in West Virginia, not just over electricity sold within the state.

A recent development in the area of generation of electricity taxation necessitates an examination of the new West Virginia tax. In Arizona Public Service Co. v. Snead, the United States Supreme Court invalidated a New Mexico generation of electricity tax. The Court determined that the New Mexico tax was discriminatory under a provision of the Tax Reform Act of 1976. Because of the similarities between the New Mexico tax and West Virginia's generation of electricity tax, the validity of the West Virginia tax is now in question.

This Note will examine both the Snead case and the provision of the Tax Reform Act on which the Court based its holding, as well as their implications for West Virginia's generation of electricity tax. Further discussion will focus on the Supreme Court's past interpretation of discriminatory state taxes and the Court's acceptance of generation of electricity taxes, both in the absence of congressional guidance.

II. THE CONGRESSIONAL PROHIBITION OF DISCRIMINATORY STATE TAXES ON THE GENERATION OF ELECTRICITY

In 1975 the New Mexico Legislature passed the Electrical Energy Tax Act. This tax could be credited against the gross

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10 The 1979 net tax liability for generators of electricity under the generation of electricity tax was $27,865,986.15. West Virginia public utilities taxed under the public utility tax received a tax bill totaling $24,452,561.94. West Virginia State Tax Department.
13 N.M. Stat. Ann. §§ 7-18-1 through 7-18-6 (1978) [hereinafter referred to as the EETA]. The EETA imposed a $.0004 tax on each kilowatt hour of electricity
receipts tax in New Mexico if the electricity was consumed within the state. Electricity consumed outside the state received no similar credit for taxes paid in other states.

Five major public utilities generating electricity in New Mexico and transmitting at least part of their electricity outside the state brought an action challenging the act in the state district court. While this action was pending, Congress passed a statute prohibiting states from imposing discriminatory taxes on the generation of electricity. The plaintiff utility companies moved for summary judgment. In response, defendant Fred O'Chesky, Commissioner of Revenue, filed a cross-motion for summary judgment. The district court ruled in favor of the Commissioner.

The plaintiff utility companies appealed the judgment to the New Mexico Supreme Court and reasserted their contention that the tax violated the supremacy and commerce clauses of the United States Constitution. Plaintiffs argued that under the

generated in the state. This tax amounted to approximately two percent of gross sales.

14 Id. § 7-9-80 (1978). New Mexico also imposes a four percent gross receipts tax on retail sales of electricity within the state. N.M. Stat. Ann. § 7-9-4 (1978). Under the EETA, if a New Mexico generator sold the energy to a New Mexico consumer, he was subject to both the two percent EETA and the four percent gross receipts tax. However, the credit provision provided in the EETA permitted the generator to receive a tax credit on the four percent gross receipts tax when he paid the two percent EETA.

A more complicated situation arose, however, when the New Mexico generator of electricity was simply a wholesaler and only distributed the electricity to retailers within the state. The generator was still liable for the EETA, and the retailer had to pay the gross receipts tax. In this situation the retailer reimbursed the generator for the EETA tax paid and then received the tax credit in the amount of the EETA tax on his gross receipts tax.

15 See Arizona Pub. Serv. Co. v. O'Chesky, 91 N.M. 485, 576 P.2d 291 (1978). Two actions were originally filed, one in the district court of New Mexico and the other in the United States Supreme Court. In the Supreme Court, the State of Arizona filed a motion for leave to file a complaint under the Court's original jurisdiction over cases involving controversies between two or more states. U.S. Const. art. III, § 2. The Court declined to exercise its original jurisdiction over the case primarily because the constitutionality of the EETA was already under consideration in the New Mexico district court. Arizona v. New Mexico, 425 U.S. 794 (1976).

17 U.S. Const. art. VI, cl. 2.
supremacy clause the federal statute prohibiting discriminatory state taxes on the generation of electricity rendered the New Mexico tax void. They further asserted that the New Mexico tax was an unconstitutional burden on interstate commerce. In response to these contentions, the New Mexico Supreme Court determined that the EETA did not come within the terms of the federal statute prohibiting such taxes and that the tax was not a burden on interstate commerce. The United States Supreme Court, however, reversed the holding of the state court, finding the tax invalid by reason of the federal statute prohibiting discriminatory state taxes on the generation of electricity. The Court, therefore, did not address the commerce clause issue.

While the case was pending before the state district court, Congress enacted section 2121(a) of the Tax Reform Act of 1976, which provides:

No state, or political subdivision thereof, may impose or assess a tax on or with respect to the generation or transmission of electricity which discriminates against out-of-state manufacturers, producers, wholesalers, retailers, or consumers of that electricity. For purposes of this section, a tax is discriminatory if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce.

The utility companies argued that since the EETA provided a credit for intrastate sales without a corresponding credit for electricity transmitted in interstate commerce, it was discriminatory and the Tax Reform Act preempted the tax, rendering it invalid. The state supreme court analyzed the statutory language defining discriminatory and concluded that the EETA was not discriminatory within the meaning of the Tax Reform Act. In making such a determination the court focussed on the phrase greater tax bur-

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20 Arizona Pub. Serv. Co. v. Snead, 441 U.S. 141 (1979). After the New Mexico Supreme Court decided the case but before the case was argued before the United States Supreme Court, Arthur Snead replaced Fred O'Chesky as New Mexico's Commissioner of Revenue, which explains the change in the name of the defendant.
22 Id.
The court interpreted the word *greater* to mean "larger," not "additional." Since the EETA was only a two percent tax while intrastate sales of electricity were subject to a four percent tax, the court concluded that the tax burden on interstate commerce was smaller and, therefore, not in violation of the Tax Reform Act.\(^2\)

In response to the argument that the tax credit caused the discrimination, the court focussed on the burden on interstate electricity at the time it leaves the state as compared to the tax burden on intrastate electricity at the time of delivery. Under this analysis the intrastate electricity is subject to a minimum of a four percent tax on gross sales, whereas the interstate electricity is subject to only a two percent rate.\(^3\)

The United States Supreme Court determined that the New Mexico court had misinterpreted the Tax Reform Act. Justice Stewart, writing the majority opinion, concluded that the EETA was discriminatory within the meaning of the federal statute. Using strict statutory construction, he determined that the Tax Reform Act directed a reviewing court to focus *only* on the generation of electricity tax and not on other tax provisions when considering discrimination under the federal statute: "To look narrowly to the type of tax the federal statute names, rather than to consider the entire tax structure of the State, is to be faithful not only to the language of that statute but also to the expressed intent of Congress in enacting it."\(^4\)

Further, the Supreme Court relied on the legislative history of the Tax Reform Act to determine that the statute was aimed at taxes such as New Mexico's. The Senate Finance Committee Report\(^5\) made it clear that the generation of electricity tax imposed by New Mexico was the type intended to be prohibited by the statute:

> The committee has learned that one State places a discriminatory tax upon the production of electricity within its boundaries for consumption outside its boundaries. While the


\(^{24}\) *Id.*


rate of the tax itself is identical for electricity that is ultimately consumed outside the State and electricity which is consumed inside the State, discrimination results because the State allows the amount of the tax to be credited against the gross receipts tax if the electricity is consumed within its boundaries. This credit normally benefits only domiciliaries of the taxing State since no credit is allowed for electricity produced within the State and consumed outside the State. As a result, the cost of the electricity to nondomiciliaries is normally increased by the cost the producer of the electricity must bear in paying the tax. However, the cost to domiciliaries of the taxing State does not include the amount of the tax.

The committee believes that this is an example of discriminatory State taxation which is properly within the ability of Congress to prohibit through its power to regulate interstate commerce.\textsuperscript{27}

The report's mention of "one State" was in reference to New Mexico, as the name of the state was disclosed in a Senate debate over the statute.\textsuperscript{28}

Using the Court's analysis, the EETA is discriminatory under the Tax Reform Act. The statute expressly forbids the imposition by a state of any tax "on or with respect to the generation of electricity" which is "discriminatory." A "discriminatory" tax, defined by and for the purposes of the statute, is one which "results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce" than on energy consumed locally.\textsuperscript{29} Through the operation of the credit provision of the EETA, the tax imposed will never be paid for energy consumed in New Mexico. No similar credit is provided for electricity generated in New Mexico but consumed in other markets. Electricity generated and ultimately consumed in New Mexico is not subjected to the burdens of the EETA, but electricity transmitted for consumption in other states is taxed.\textsuperscript{30}

The discriminatory effect of the EETA on electricity transmitted outside the state exists only if the tax is viewed singularly,

\textsuperscript{27} Id.

\textsuperscript{28} 441 U.S. 141, 147 (1979).


\textsuperscript{30} See note 14 supra.
as the Court requires.\textsuperscript{31} However, if the EETA is viewed in conjunction with the entire tax structure of the state, the discrimination disappears since electricity consumed in New Mexico is subjected to a four percent tax, whereas electricity sent out-of-state is subjected to the two percent EETA.\textsuperscript{32}

The Court, in the absence of congressional legislation, has maintained that in order to establish a tax as discriminatory, "a proper analysis must take 'the whole scheme of taxation into account.'"\textsuperscript{33} The interpretation of a discriminatory tax under the Tax Reform Act, therefore, conflicts with the Court's past decisions interpreting discrimination under the commerce clause.\textsuperscript{34}

III. THE APPLICABILITY OF THE TAX REFORM ACT TO WEST VIRGINIA'S GENERATION OF ELECTRICITY TAX

The central question concerning West Virginia's generation of electricity tax is whether the Tax Reform Act, as interpreted by the Supreme Court in \textit{Arizona Public Service Co. v. Snead},\textsuperscript{35} invalidates the West Virginia tax. The Court in \textit{Snead} provided no indication of how it would apply the Tax Reform Act to a tax scheme like West Virginia's. On the contrary, Justice Stewart stated that "[t]he amici in this case have pointed to several similar state taxes on the generation of electricity. [Pennsylvania, Washington, and West Virginia]... None of these States, however, has adopted precisely the scheme used by New Mexico, and we express no opinion as to the validity of these or any other state tax laws."\textsuperscript{36} The Court, in not applying the Tax Reform Act to West Virginia's generation of electricity tax, upheld the constitutionally imposed limitation of deciding only "cases and controversies."\textsuperscript{37} Thus, in order to apply the Court's analysis in \textit{Snead} to the West Virginia tax, it is necessary to determine whether the New Mexico and West Virginia generation of electricity taxes are comparable.

\textsuperscript{31} 441 U.S. 141, 149-50 (1979).
\textsuperscript{32} See note 14 supra.
\textsuperscript{33} Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 69 (1963) (quoting Galveston, H. & S.A.R. Co. v. Texas, 210 U.S. 217, 227 (1908)).
\textsuperscript{34} See Part IV infra.
\textsuperscript{35} 441 U.S. 141 (1979).
\textsuperscript{36} Id. at 147 n.7.
\textsuperscript{37} U.S.-CONST. art. III, § 2.
First, New Mexico imposed a tax on both the generation of electricity within the state (the EETA) and the sale of electricity to New Mexico consumers. West Virginia also taxes both of these activities. Second, under the New Mexico scheme, in-state electric generators who sold the energy to resident consumers automatically received a tax credit which was applied to the tax imposed on the sale of electricity within the state. In West Virginia, instead of receiving a tax credit, those generators who sell to West Virginia consumers are exempt from paying the generation of electricity tax altogether; they are only subject to the public utility tax. The purposes and effects of the New Mexico credit scheme and the West Virginia exemption scheme are the same: The purpose in both states is to insure that the sale of electricity to consumers does not bear the tax burden of both the generation of electricity tax and the public utility tax; the effect is to place the burden of the generation of electricity taxes on electricity transmitted in interstate commerce. Finally, the rate of the generation of electricity tax under either tax scheme is not greater than the public utility tax. In West Virginia the tax rates are the same. In New Mexico the rate for the EETA was approximately one-half the rate of the tax for intrastate sales. Therefore, neither state subjects electricity transmitted in interstate commerce to a higher rate than that imposed upon intrastate sales. Since the New Mexico EETA and the West Virginia generation of electricity tax are substantially similar, the application of the Snead decision to the West Virginia tax is appropriate.

59 Id. §§ 7-9-1 through 7-9-80.
61 See note 14 supra.
63 Both the public utility tax and the generation of electricity tax are imposed at the rate of four percent of gross sales.
64 Retail sales of electricity in New Mexico are subjected to a four percent gross receipts tax under N.M. STAT. ANN. §§ 7-9-1 through 7-9-80 (1978). Under the EETA, a tax is imposed upon the generation of electricity at the rate of approximately two percent of gross sales.
In *Snead*, the Court looked at two factors in deciding that the New Mexico tax was discriminatory under the Tax Reform Act. First, the federal statute was "directed specifically at a state tax 'on or with respect to the generation or transmission of electricity.'" The Court interpreted this as directing a court to look only at the generation of electricity tax and "not to the entire tax structure of the State" in order to determine discrimination. Since the EETA was concededly a tax on the generation of electricity, the Tax Reform Act was applicable.

Second, the Court determined that the full burden of the EETA, with its credit provision, fell on out-of-state sales of electricity. This effect is defined as discriminatory under the statute and is prohibited; therefore, New Mexico's EETA was invalidated.

When these two factors are applied to West Virginia's generation of electricity tax, the same result occurs. Since the West Virginia tax is a generation of electricity tax, the application of the Tax Reform Act is triggered. Furthermore, the generation of electricity tax will be analyzed sans the public utility tax to determine if it is discriminatory. Moreover, because West Virginia electric utilities are exempted from the generation of electricity tax, the electricity generated in West Virginia but transmitted in interstate commerce carries the full burden of the tax. Like the EETA, this is discriminatory under the Tax Reform Act. If West Virginia's generation of electricity tax is viewed singularly, as was

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46 Id. at 149.

47 Id.

48 Id. at 150.

49 The two states' tax schemes could possibly be distinguished by the fact that the two provisions in West Virginia are under the same tax (the West Virginia Business and Occupation Tax), whereas the comparable provisions in New Mexico are two separate taxes. If a reviewing court would view both West Virginia taxes together when determining whether the generation of electricity tax violates the Tax Reform Act, it could hold that the generation of electricity tax is not discriminatory under the federal statute. The *Snead* Court, however, emphasized that only the one tax (the generation of electricity tax) is to be examined. This holding may restrain a reviewing court from doing otherwise.

the EETA, the Tax Reform Act will be applied to invalidate it.

IV. THE WEST VIRGINIA TAX WITHSTANDS A COMMERCE CLAUSE ATTACK.

The Supreme Court, in the absence of congressional direction, has closely scrutinized state taxes alleged to discriminate against interstate commerce. The Court’s basis for such scrutiny has been the commerce clause of the United States Constitution. Although the commerce clause is framed as a grant to Congress of the power to regulate interstate and foreign commerce, it has long been interpreted as restricting state taxing powers, despite congressional silence.51

The problem with examining West Virginia’s generation of electricity tax singularly for discrimination under the Tax Reform Act is that it ignores West Virginia’s public utility tax which is imposed upon electricity sold to in-state consumers.52 Electricity transmitted in interstate commerce is not subject to the public utility tax. The Tax Reform Act, by the Court’s interpretation in Snead, may label West Virginia’s generation of electricity tax “discriminatory” even though electricity transmitted in both intrastate and interstate commerce is subject to a four percent tax. It is important, therefore, to examine the Court’s own “test” for determining that a tax is discriminatory and in violation of the commerce clause in order to analyze the rationale for finding such a violation. In this way the Tax Reform Act may be evaluated as to its fairness to both interstate commerce and the state’s power to tax.

The essential principle enunciated by the Court is that the commerce clause, by its own force, prohibits the states from imposing “undue burdens” on interstate commerce. However, the Court has repeatedly recognized that the commerce clause does not “eclipse the reserved ‘power of the States to tax for the support of their own governments.’”53 Furthermore, interstate com-

51 See, e.g., Case of the State Freight Tax, 82 U.S. (15 Wall.) 232 (1872), which was the first decision invalidating a state tax as a violation of the unexercised power of Congress to regulate the commerce.


merce is not immune from state taxation. The mere fact that a person carries on business in interstate commerce does not exempt him from such taxation. As the Court has reiterated, it was not the purpose of the commerce clause to relieve those engaged in interstate commerce from carrying a fair share of the costs of state government in return for the benefits they have received from the state.54

However, in order for a state to validly tax a business engaged in interstate commerce, it must impose the tax on an activity with a substantial nexus with the taxing state.55 Furthermore, the tax must be apportioned fairly, must not discriminate against interstate commerce, and must be related to the services provided by the state.56

Under this test, a state tax may not discriminate against interstate commerce. Such discrimination results when a state tax provides a direct commercial advantage to intrastate businesses


55 This “nexus” question requires a due process, rather than a commerce clause, analysis. The due process clause has long been recognized as a limitation on state taxing power. The absence of any connection in fact between the taxed commerce and the state is sufficient for invalidating a tax on due process grounds. In sweeping due process language, the Court has declared that a “state may not tax real property or tangible personal property lying outside her borders; nor may she lay an excise or privilege tax upon the exercise or enjoyment of a right or privilege in another state derived from the laws of that state and therein exercised and enjoyed.” Great A & P Tea Co. v. Grosjean, 301 U.S. 412, 424 (1937) (footnotes omitted). Briefly, then, due process is concerned with whether the tax, in practical operation, is based upon opportunities, benefits, or protections conferred or afforded by the taxing state or the taxpayer.

Under the generation of electricity tax, there is no conflict with the due process clause. In order to be subject to the tax, a utility must generate electricity within the taxing state. This requirement provides the nexus between the state and the activity being taxed. For a more extensive examination of the due process clause limitations on state taxation, see Note, Constitutional Law—State Taxation of Interstate Commerce—Commerce Clause Analysis, 76 W. Va. L. Rev. 380 (1974) [hereinafter cited as Commerce Clause Analysis].

over interstate businesses.\textsuperscript{57} A state tax which has this effect is prohibited for two reasons. First, "[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects."\textsuperscript{58} Second, a state tax that discriminates against interstate commerce encourages people to trade only within the taxing state.\textsuperscript{59} These effects generally have been found to occur simultaneously.\textsuperscript{60}

In determining whether a state tax presents one of these situations and, therefore, discriminates against interstate commerce, the Court has repeatedly emphasized that it will look at the practical operation or effect of the state tax and not to its formal language.\textsuperscript{61} The Court thus considers two propositions in its determination of whether a tax is discriminatory. First, a state tax must not provide a commercial advantage to intrastate commerce over interstate commerce or encourage people to trade only within the

\textsuperscript{60} Id. In this case, the Court invalidated a New York statute which discouraged people to trade on the New York Stock Exchange and discouraged them from trading on stock exchanges located in other states. In Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 69 (1963), the state of Louisiana imposed a use tax on manufacturers who brought equipment assembled by them in another state into Louisiana for their own use there. However, in-state manufacturers of equipment who used the equipment manufactured by them within Louisiana were not subject to the use tax nor to any other sales tax. The Court held that application of the Louisiana use tax in this situation discriminated against interstate commerce.
taxing state. Second, interstate commerce must pay its own way. West Virginia's generation of electricity tax as it relates to these two propositions is reviewed in the following subsections.

A. The West Virginia Tax Does Not Discriminate Against Interstate Commerce.

In West Virginia, utilities generating electricity for consumption within the state and utilities generating electricity for sale elsewhere are subject to equal taxes. Therefore, the tax scheme does not violate the commerce clause. Justice Rehnquist, in his concurring opinion in Snead, remarked that if the Tax Reform Act had no more effect than the commerce clause, then the New Mexico EETA would have been valid. A look at the net functional effect of the West Virginia public utility and generation of electricity taxes demonstrates that there is no discrimination against interstate commerce. The state wanted to tax the generation of electricity for transmission outside the state without imposing an additional tax on electricity sold in West Virginia. The legislators achieved this result by providing an exemption in the generation of electricity tax for utilities that pay the public utility tax. Under the Tax Reform Act, such effect of the generation of electricity tax is discriminatory since generators transmitting the power in interstate commerce bear the full burden. While this is true, it is purely a matter of form; the exemption scheme is simply the device for insuring that the tax burden on intrastate commerce is not increased. All electricity generated in West Virginia is subjected to the same amount of tax.

The Supreme Court, in evaluating state taxes challenged under the commerce clause, has pierced the form of a state tax in order to analyze the practical effects. This pragmatic analysis is readily seen in the Court's interpretations of state sales and use taxes. A sales tax generally is imposed on sales to the ultimate consumer. The use tax is imposed on the local privilege of using property in the taxing state which would have been subject to the sales tax had the property been purchased in the taxing state. Since the use tax generally is due only on an article upon which

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64 See note 43 supra.
the local sales tax has not been paid, the compensating use tax complements the local sales tax.

The constitutionality of the compensating use tax has been upheld by the Supreme Court over the argument that the tax discriminates against interstate commerce. In *Henneford v. Silas Mason Co.*, the Court, stressing the equality existing between the use tax and corresponding sales tax, reasoned that the non-discriminatory tax was imposed not on the privilege of doing interstate business but on the local privilege of using the goods after the interstate journey had ended. The sales and use tax cases indicate that in order to establish a tax discrimination that cannot withstand the interdiction of the commerce clause, the taxpayer must prove that the burden imposed on the interstate transaction is greater than the burden imposed on a strictly local transaction.

The effect of the sales/use tax scheme is closely analogous to that of the West Virginia generation of electricity/public utility tax scheme. As with the sales tax, the burden of the public utility tax falls on in-state consumers. Under the use tax and generation of electricity tax, the burden falls on interstate commerce. The use tax protects local merchants who lose business because their customers buy goods out of state in order to avoid paying the local sales tax. The generation of electricity tax insures that the costs involved in the generation of electricity are distributed to all consumers of the energy, not just to West Virginia consumers.

When viewed in this way, West Virginia's generation of electricity tax is not discriminatory. There is no commercial advantage to intrastate commerce over interstate commerce since electricity consumed outside the state is not in competition with electricity consumed within the state. Further, the tax scheme does not encourage generators to produce and transmit electricity only within the state since electricity sold in both intrastate and

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interstate commerce is subjected to the same amount of tax. 7

A court's decision on the issue of discriminatory taxation should rest on the practical and functional effect of the state's total tax structure for electricity. Applying this standard, no serious criticism can be made of the West Virginia tax. The exemption provision insures that all electricity generated within the state is taxed evenly. Thus, the state's tax structure is designed to tax the generation of electricity, but to do so only once.

B. All Generators of Electricity Must Pay Their Own Way.

The Supreme Court has recognized that a state may properly tax a business engaged in interstate commerce where the business has benefited from the opportunities and protection which the state has afforded. 8 One technique the Court has used to rationalize the state taxation of an interstate business has been to label part of the business activity a "local incident." By separating the local activity from the interstate activity, the Court has permitted a state to tax the "local incident." State taxes imposed on the businesses of manufacturing 9 and mining 10 have long been sustained even though the goods manufactured or mined were immediately shipped in interstate commerce. The Court's justification

7 A different situation existed in Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 334-35 (1977), where the Court invalidated state taxes because they provided a commercial advantage to local commerce and encouraged trade within the state to the detriment of interstate commerce.

8 In General Motors Corp. v. Washington, 377 U.S. 436 (1964), a case involving the constitutionality of a privilege tax measured by gross receipts, the Court stated:

[T]he validity of the tax rests upon whether the State is exacting a constitutionally fair demand for that aspect of interstate commerce to which it bears a special relation. For our purposes the decisive issue turns on the operating incidence of the tax. In other words, the question is whether the State has exerted its power in proper proportion to appellant's activities within the State and to appellant's consequent enjoyment of the opportunities and protection which the State has afforded. Where, as in the instant case, the taxing State is not the domiciliary State, we look to the taxpayer's business activities within the State, i.e., the local incidents, to determine if the gross receipts from sales therein may be fairly related to those activities.

Id. at 440-41.


10 Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923).
for the validity of such taxes is that the in-state activities are purely local in nature and can be separated from the interstate activity.\textsuperscript{71}

In \textit{Utah Power & Light Co. v. Pfost},\textsuperscript{72} the same rationale was used to sustain a tax on the generation of electricity even though most of the energy generated was transmitted in interstate commerce. The Supreme Court analogized the generation of electricity to the manufacture of goods, thereby separating the local conversion from the interstate transmission. The Court, in using the "local incidents" rationale, stated that "[w]hile conversion and transmission are substantially instantaneous, they are, we are convinced, essentially separable and distinct operations."\textsuperscript{73}

The Supreme Court of Appeals of West Virginia had the opportunity to review the state's generation of electricity tax when it was under the manufacturer's tax in \textit{Virginia Electric & Power Co. v. Haden}.\textsuperscript{74} The tax had been attacked on the grounds that it constituted an unlawful burden on interstate commerce.\textsuperscript{75} The West Virginia court sustained the tax against such attack, adopting the "local incidents" analysis used by the United States Supreme Court in \textit{Utah Power & Light Co.}\textsuperscript{76}

It is imperative that electric generators who produce electricity within the state pay their own way. The generation of electricity within West Virginia has created social costs which, prior to the generation of electricity tax, were almost entirely borne by West Virginia consumers. Generators have found that they may produce the electricity cheaper in this state since the coal used to produce the energy is located here. Since much of the Central East depends on West Virginia for its energy supplies, without the generation of electricity tax these states would be able to transfer the costs of generating electricity to West Virginia. Although this state has a very real interest in the production of electricity within its borders,\textsuperscript{77} it also has a very real interest in

\begin{footnotes}
\footnotetext[71]{For a fuller development of the "local incidents" test, see Commerce Clause Analysis, supra note 55, at 382-83.}
\footnotetext[72]{286 U.S. 165 (1932).}
\footnotetext[73]{Id. at 179.}
\footnotetext[74]{200 S.E.2d 848 (W. Va. 1973), cert. denied, 416 U.S. 916 (1974).}
\footnotetext[75]{Id. at 855.}
\footnotetext[76]{Id. at 855-56.}
\footnotetext[77]{West Virginia's interest in attracting industry, including electric power}
\end{footnotes}
insuring that its citizens do not bear the costs of generation of electricity while other states reap the benefits.

V. AMENDMENT TO THE TAX SCHEME

The survival of West Virginia's generation of electricity tax has been threatened in Duquesne Light Co. v. State Tax Department of West Virginia,76 a case pending before the Circuit Court of Kanawha County. Since the tax may very likely be invalidated, the West Virginia Legislature should consider amending the structures of both the generation of electricity tax and the public utility tax. A possible amendment to the present scheme is presented here.

The Snead Court invalidated the New Mexico tax because the burden of the tax fell on electricity transmitted in interstate commerce. The West Virginia generation of electricity tax produces the same result. Therefore, the problem with the generation of electricity/public utility tax scheme is that generators transmitting electricity within the state pay the public utility tax and generators transmitting outside the state pay the generation of electricity tax. The burden of the latter tax falls on interstate commerce. This problem may be resolved by imposing the generation of electricity tax on all West Virginia generators. The discrimination argument would disappear since West Virginia-generated electricity sold to in-state consumers would be subject to the same tax.

However, a problem is created by this recommended scheme: since public utilities generating electricity within West Virginia are required also to pay the public utility tax, they would be subject to two taxes, which would be passed on to West Virginia consumers. Therefore, the public utility tax likewise must be amended to provide a credit for West Virginia utilities subject to

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76 No. CA-78-1986 (W. Va., filed May 29, 1978).
the generation of electricity tax.

Such a credit, however, is discriminatory under the Tax Reform Act for the same reason the generation of electricity tax is presently discriminatory: electricity generated outside the state and transmitted and sold to West Virginia consumers would carry the full burden of the public utility tax. To insure the validity of the amended public utility tax, the legislature should extend the credit to all generators of electricity subject to a generation of electricity tax. In this way, if any state imposes a tax on the generation of electricity and this electricity is transmitted and sold to West Virginia consumers, a credit in the amount of the generation of electricity tax would be applied to the public utility tax to reduce this tax burden. Therefore, the amended public utility tax would not discriminate against electricity transmitted from outside the state since the credit provision would apply to all electricity subject to a generation of electricity tax, not just to electricity generated within the state.

There is a financial drawback to the proposed amendment. Under the present scheme, all electricity consumed in West Virginia is subject to the public utility tax. The proposed public utility tax, on the other hand, would provide a credit to generators who have already been subjected to a generation of electricity tax. This credit would necessarily decrease the total amount of revenue received by the state under the present scheme. However, such a decrease in tax receipts would not be as great as the decrease that would result if the generation of electricity tax were invalidated.

VI. Conclusion

Congress has generally taken a passive role in defining the states’ taxing powers in interstate commerce. However, by enacting section 2121(a) of the Tax Reform Act, Congress has stepped into the area of the taxation of the generation of electricity in an attempt to prevent states from subjecting interstate commerce to discriminatory taxes. The problem here is that the legislation as interpreted in Snead is overbroad, i.e., the Tax Reform Act invalidates not only actually discriminatory taxes in this area but also legitimate generation of electricity taxes.

A state has the power to protect the physical and economic welfare of its citizens through the taxation of activities that pro-
duce deleterious effects for the general welfare of the populace and that in turn benefit residents of other states. By consuming electricity generated in West Virginia, other states have exported some of their air pollution and other problems to West Virginia. A prohibition of West Virginia’s generation of electricity tax will force this state, like New Mexico, to assume more of the social and environmental costs while other states enjoy the benefits of electricity without the costs of generating it within their borders.

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