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In the Supreme Court of Florida

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Shell Oil Company,

Petitioner,

v.

Department of Revenue,

Respondent.

Case Nos. 66,240
66,254

On Review from the District Court of Appeal, First District

Petitioner's Initial Brief

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Preliminary Statement

This is a proceeding to review a decision of the First District Court of Appeal which upholds the imposition of Florida corporate income tax on oil and gas production income of Shell Oil Company on the Outer Continental Shelf of the United States.[1] Shell excluded the income derived from its production on the Outer Continental Shelf from its Florida income, on the basis of federal preemption and supremacy directives prescribed in the United States Constitution and in federal legislation governing the Outer Continental Shelf. These directives are also acknowledged expressly in Florida's income tax code.

The district court upheld Florida's right to tax this income by framing the controversy as one involving nothing more than income derived "from the sale in the United States" of oil which was extracted from wells located on the Outer Continental Shelf. Based on that characterization, the court held that income from sales of that nature are not excludable from Florida income. As the court apparently misconceived the constitutional and statutory limitations on the reach of Florida's taxing jurisdiction, Shell asked that the court certify to this Court whether the department is prohibited by federal law from taxing

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[1]The district court's decision is reported at 9 F.L.W. 769, rehearing denied at 9 F.L.W. 2315.

income derived from the Outer Continental Shelf.[2] The district court agreed that the issue is important and one of first impression in the nation, but again reverting to its characterization of the issue as one involving simply the sale of oil in the United States certified the following question:

> Whether the State of Florida is prohibited by 43 U.S.C. §1333(a)(2)A from imposing a tax upon income derived from the sale in the United States of oil extracted from the Outer Continental Shelf?

As Shell will demonstrate, the question asked is not the question posed by this lawsuit.

Shell's challenge to the imposition of income tax in this case asks

> whether Florida is prohibited from taxing income from the production of crude oil and natural gas on property of the United States denominated as the Outer Continental Shelf.

A fundamental distinction separates the two questions. The district court's question hinges on when income is taxed, an issue of timing only.

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[2] 9 F.L.W. at 2316.

It is characterized in the world of taxation by the label "realization", and it is normally determined by reference to a "sale".

The key to this lawsuit, however, hinges on where income is earned, for Florida is absolutely barred from taxing income which is earned on the far-flung federal lands which are generically called Outer Continental Shelf. The Court's responsibility in this case, we believe, will be simplified by bearing in mind that the barrier to taxation here is geographical, not temporal, and that this barrier operates irrespective of when the occasion for taxing is otherwise appropriate.

Statement of the Case

Shell brought suit in Leon County Circuit Court challenging the assessment of Florida corporate income tax on Shell's Outer Continental Shelf production income for its fiscal years 1972 through 1975.[3] In an entirely separate issue, the trial court sustained Shell's position that intangible drilling costs must be included in the property factor of its apportionment formula.

Both parties appealed to the district court, which affirmed the trial court's summary judgment in both respects. Following certification of the Outer Continental Shelf income question, both parties independently asked this Court to accept the case for review.

On December 14, 1985, the Court accepted jurisdiction, consolidated the parties' petitions, and set a briefing schedule. At Shell's request, a revised briefing schedule was approved which set March 4 as the service date for Shell's initial brief.

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[3] An alternate contention raised by Shell in its complaint, requesting relief from the department's interpretation of the apportionment formula, was withdrawn before the trial court entered final summary judgment. As a result, the trial court never ruled on that issue.

Shell has invoked the Court's discretionary jurisdiction, on the basis of the district court's certified question, in order to obtain a declaration that the exclusion of all Outer Continental Shelf income from Florida's income tax is required by Florida and federal law. As to the apportionment issue discussed in the district court's opinion, which involves only how much of the income earned by a multi-state enterprise may be attributed to Florida as opposed to what items actually compose the amount of taxable income itself, Shell believes the district court has mistakenly sanctioned an unconstitutional distortion of Florida's apportionment formula.[4] That is, the court has allowed the formula for attributing to Florida a portion of Shell's nationwide business activities to skew Florida's share in a way which affronts the United States Constitution and federal law. To avoid confusion on the important "exclusion" issue, however, Shell elects not to argue the apportionment issue before the Court.

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[4]The appropriate correlation of includable income items, and the formula for apportioning that income to Florida, was identified in Heftler Construction Co. v. Department of Revenue, 334 So.2d 129 (Fla. 3d DCA 1976), cert. denied, 341 So.2d 1082 (Fla. 1977). Cf. Continental Illinois National Bank & Trust Co. v. Lenckos, 464 N.E.2d 1064 (Ill.), cert. denied, 105 S.Ct. 296 (1984); see also Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983), describing the necessity for an apportionment formula which contains both internal and external consistency.

Statement of the Facts

Shell is a Delaware corporation with its principal offices in Houston, Texas. Its business includes the extraction or production of oil and gas in more than a dozen of the United States, and on the Outer Continental Shelf of the United States. (R. 62). Shell refines petroleum products in seven states, operates chemical plants in some of those states, and markets its products throughout the United States. Within Florida, Shell's principal business is marketing oil and chemical products. (R.61).

A portion of Shell's net income for the years in controversy was attributable to Shell's extraction and disposition of crude oil and natural gas from the Outer Continental Shelf. The Outer Continental Shelf is defined in 43 U.S.C. § 1331(a) as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control. . . ." Section 1301 of Title 43, United States Code, is part of he Submerged Lands Act, 43 U.S.C. §§ 1301-1343, and defines "land beneath navigable waters" as essentially that area within three miles of coast of

the United States.[5]

The right to conduct exploration and production activities on the Outer Continental Shelf was acquired by lease from the United States government. For the privilege of conducting its vast and extensive exploration and production activities there, Shell pays the United States a negotiated royalty on the oil and gas production which results from these activities. By law, no taxes, fees, or royalties of any kind are payable to any state on this production. 43 U.S.C. §§ 1331-43.

The Outer Continental Shelf is not a geographic feature so much as a legal term describing all underwater lands three miles or more from the shore of any state. The United States has established economic and territorial jurisdiction over the Outer Continental Shelf, which surrounds not only the continental forty-eight states but Alaska and Hawaii. No portion of the Outer Continental Shelf is located in the State of Florida or any other of the fifty states.

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[5] Although not relevant to this case, the jurisdiction of Florida and Texas extend three marine leagues into the Gulf of Mexico rather than three statute miles. United States v. Texas, 339 U.S. 707 (1950); United States v. Florida, 363 U.S. 121 (1960). For reference simplicity, however, Shell will describe the state-federal boundary as a three mile limit throughout this brief.

In non-technical terms, Outer Continental Shelf production activity involves platform drilling into lands below the oceans and seas more than three miles from the territorial limits of any state. The production process consists of the physical acts of erecting platforms, drilling into the seabed, extracting mineral products (oil and gas) from beneath the seabed, delivering them up onto the drilling platform, and then causing their transfer into pipes or barges for delivery to landside receiving points in any one or more of the several states.

Net income in the following amounts was attributable to Shell's production of oil and gas on the Outer Continental Shelf:

Year	Amount
1972	$ 76,410,281
1973	112,410,386
1974	134,006,600
1975	92,233,400

These amounts represent transfer prices for crude oil and natural gas delivered to pipelines at the producing platforms on the Outer Continental Shelf, less related costs and expenses. In the case of natural gas, all transfers are made by sale to non-affiliated, independent pipeline companies which rent space on the platform. In the case of crude oil, some transfers are made by sale to independent third parties on the platform, but

most are delivered to Shell's own pipeline for transport to shore.

Neither Shell nor any other petroleum company refines or otherwise changes the character of crude oil on Outer Continental Shelf platforms. Sales of natural gas and crude oil to independent third parties are concluded transactions on the Outer Continental Shelf, and they constitute and have been treated by Shell as taxable events for federal income tax purposes. Earnings from these sales were excluded from Shell's taxable income for Florida income tax purposes.

The transfer of crude oil into Shell's pipeline on the platform also represents a concluded transaction, and likewise generates earnings which are excludable for Florida income tax purposes. The revenue generated by crude oil transfers is determined by the fair market value of crude oil at the wellhead, a standard and accepted method of determining a sales equivalent for several purposes, such as computing royalties paid to the United States government for Outer Continental Shelf leases, computing income from Outer Continental Shelf property under sections 613 and 613A of the Internal Revenue Code in lieu of actual sales to outsiders, and computing the federal windfall profit tax.

Shell has been consistent in its treatment of earnings from arms-length sales of crude oil and natural gas on platforms to outsiders, and the transfer of crude oil at wellhead

prices into Shell's transporting pipeline on platforms. For each of the years in controversy, Shell excluded all oil and gas production revenue from its adjusted federal income apportionable to Florida, less costs and expenses related to that production income. (R.62).

Summary of Argument

The Florida corporate income tax code recognizes federal preemption and constitutional tax limitations by expressly excluding from the Florida tax "any item or items of income" which would not be proper to include in Florida income because of a conflict with any federal statute, the Constitution of the United States, or the Constitution of Florida.[6] Congress has enacted legislation which exercises full federal sovereignty over the Outer Continental Shelf, and which expressly declares that "state taxation laws shall not apply to the outer Continental Shelf."[7]

The Florida income tax code is a "state taxation law."[8] Federal law unequivocally preempts all forms of state taxation applicable to income-producing activities on the Outer Continental Shelf. The income earned from sales of natural gas and crude oil on Outer Continental Shelf platforms to third parties, and the income earned from the transfer of crude oil to pipelines in lieu of sales, are excludable items

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[6] § 220.02(5), Fla. Stat.

[7] 43 U.S.C. § 1333(a)(2)(A).

[8] § 220.02, Fla. Stat.

of income for Florida income tax purposes. Shell properly excluded from its Florida net income the income it derived from production activities on the Outer Continental Shelf.

Argument

Florida is prohibited from imposing a tax on income derived from the production of crude oil and natural gas on property of the United States denominated as the Outer Continental Shelf.

This case involves the tax base on which Florida imposes its excise tax on corporations, measured by net income, for the privilege of doing business in this state.[9] That base is essentially derived from a corporate taxpayer's federal income tax return, with adjustments either allowed by the State of Florida as a matter of legislative grace or required as a consequence of federal and constitutional limitations.

Disregarding computational steps and technical terms in Florida's income tax code which are not germane to this controversy, the tax base for computing Florida's tax is the taxpayer's share of adjusted federal income which is apportioned to Florida under formulae for that purpose contained in chapter 214 and in section 220.15, Florida Statutes.[10] There is no dispute between the parties on this point.

The Florida Legislature, however, has directed that corporate taxpayers deviate for Florida income tax purposes

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[9] § 220.02(2), Fla. Stat.

[10] § 220.12(1), Fla. Stat.

from the amount they report to the Internal Revenue Service as adjusted federal income. These deviations are dictated by policy reasons unique to Florida, and by constitutional imperatives shared with all states. In the first category are the familiar exclusions of certain income from installment sales, and amounts derived from sales outside the United States.[11] These income items are removed from a corporation's Florida tax base only because the Florida Legislature has made a policy decision for this state that the activity which produces those items is worthy of a special tax accommodation. Shell's exclusion of production income derived from the Outer Continental Shelf is not a matter of legislative beneficence which falls into this category.

The second category of excludable items is built into Florida's income tax code to prevent its reach into impermissible pockets. Items of income in this category are not specifically identified in the code by name. Rather, the legislature has merely acknowledged constitutional limitations and declared that it has no intention of taxing that which it is not permitted to tax. An example of an exclusion by declaration in this category, which is required by a tax

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[11] §§ 220.13(1)(b)2b; 220.13(1)(c), Fla. Stat.

prohibition in Florida's own Constitution, is the ban on the taxation of any income derived by natural persons, as opposed to artificial entities such as corporations.[12]

Similarly, in recognition of the limitation of state power found in the supremacy clause of the United States Constitution[13] and the correlative doctrine of federal preemption, the legislature has declared generically in section 220.02(5) that Florida will not tax income items protected by the Federal Constitution or preempted by conflicting federal statutes. That section reads:

> It is the intent of the Legislature that, if there is included in any taxpayer's net income subject to tax under this code any item or items of income which are determined to be improperly so included because of a conflict with any federal statute, the Constitution of the United States, or the State Constitution, all such items of income shall be excluded from the net incomes of all taxpayers subject to tax under this code . . . .[14]

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[12]Fla. Const., art. VII, cl. 5; § 220.02(1), Fla. Stat.

[13]U.S. Const. art. VI, cl. 2.

[14]Even if a state's income tax code did not contain a provision such as this, of course, constitutional and preemptive limitations would nonetheless bar the taxation of prohibited items.

Shell's exclusion of Outer Continental Shelf income falls squarely in this category of impermissible taxability.

The federal statutory foundation for exclusion of the income at issue in this case is found in the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a)(2)(A) ("the OCS Lands Act"). In 1953 Congress passed both the Submerged Lands Act, 43 U.S.C. §§ 1301-15, and the OCS Lands Act, 43 U.C.S. §§ 1331-43. The Submerged Lands Act confirmed proprietary title in each state to the lands and resources beneath and within the navigable water of the state, and placed the outer boundaries of the coastal states at the seaward edge of a three-mile limit.

The OCS Lands Act established clearly that the subsoil and seabed of the Outer Continental Shelf beyond this three-mile limit appertain to the United States, and are subject to its jurisdiction, control and power of disposition. 43 U.S.C. § 1332. Section 4(a)(1) of the Act extends the Constitution, laws, and civil and political jurisdiction of the United States to the Outer Continental Shelf, and to all artificial islands and fixed structures which may be erected on the Shelf for the purpose of exploring for, developing, moving, and transporting resources, to the same extent as if the Outer Continental Shelf were an area of exclusive federal jurisdiction located within a state. Section 4(a)(2) of the OCS Lands Act also guarantees the rule of law at platform drilling operations to the extent that federal law may be deficient, by extending the civil and

criminal laws of adjacent coastal states to the Outer Continental Shelf so long as they are not inconsistent with federal laws and regulations of the Secretary of Interior.

The section of the OCS Lands Act which is critical to this case is Section 1333(a)(2)(A), which flatly states:

> State taxation laws shall not apply to the outer Continental Shelf.

The term "state taxation" has been defined to include any and all respects of state and local taxing powers, without any distinction as to designation. Houck v. Little River Drainage Dist., 239 U.S. 254 (1915); Florida C. & P.R. Co. v. Reynolds, 183 U.S. 471 (1902); Hiers v. Mitchell, 95 Fla. 345, 116 So. 81 (1928); McHenry v. Downer, 116 Cal. 20, 47 P. 779 (1897).

Under this prohibition, the states lack jurisdiction to levy either direct taxes or indirect taxes. James v. Dravo Contracting Co., 302 U.S. 134 (1937). Any inclusion in Florida's tax base of natural gas and crude oil income derived from the Outer Continental Shelf violates these doctrines.

The situation here is comparable to that explored in Ramah Navajo School Board v. Bureau of Revenue of New Mexico, 458 U.S. 832 (1982). The issue there was also federal preemption, in the context of a state gross receipts tax sought to be imposed on a non-Indian company which contracted for and built an Indian school on federal land. Taxation by New Mexico of the company's revenues from the school project was held to

be impermissible because federal law had preempted the subject. Just as the burden of the state tax is Ramah actually fell on federal funds set aside for Indian schools notwithstanding that the tax was in form imposed on a non-Indian building contractor subject to New Mexico law,[15] so here the burden of Florida's income tax actually falls on federal undersea resources by adding to the cost of oil and gas production on the Outer Continental Shelf. Indeed, this case is stronger for preemption than Ramah, as there was in that case no federal statute or regulation which expressed clearly congressional intent to foreclose state taxation.

Likewise, in the James case, supra, the Court considered an "annual privilege tax" measured by profits from business and other activities. It held that the state could not levy this tax on a contractor working on government-owned land inasmuch as the United States had acquired exclusive jurisdiction over the site. "Wherever the United States has such jurisdiction the State would have no authority to lay the tax." 302 U.S. at 140. The same principle applies here. Florida has attempted indirectly to tax income earned exclusively on federal property.

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[15] Ramah Navajo School Bd., 73 L.Ed.2d at 1183.

The federal exclusion of Outer Continental Shelf production income from the tax reach of the several states, coupled with Florida's express recognition of federally-identified exclusions in its income tax code, could not be more explicit. The department does not suggest that Florida's income tax code is not a state tax law within the meaning of the OCS Lands Act, or that platform operations are not exclusively on federal property. Rather, the department has asserted (and the district court accepted) that Shell has no "platform income," so to speak, until petroleum products are sold to ultimate users. This conclusion, which reflects the department's concern for <u>when</u> earnings are appropriate for reporting and taxing, misses the point.

The issue before the Court in this case turns on <u>where</u> earnings are generated, for Congress has said and Florida has acknowledged that earnings derived from the Outer Continental Shelf are beyond the tax powers of all states. The tax treatment of income from natural gas which is sold on platforms highlights the issue. That income clearly is not within the taxing power of Florida. That income is generated "in the United States" to the same extent as income earned on federal enclaves within state boundaries, of course. But Congress has distinguished income earned on the Outer Continental Shelf from income earned on other federal lands.

The Constitution limits the state's jurisdiction to tax activities and transactions on lands under exclusive federal jurisdiction unless Congress expressly grants taxing authority to the states in those areas.[16] Only when authorized by Congress, certain income earned in federal enclaves may be included in the aggregate national earnings of a multi-national corporation to the same extent as income earned in Iowa, Alaska or any other state.[17]

Income generated on the Outer Continental Shelf, however, cannot be taken into account because Congress has expressly said it cannot. OCS Lands Act § 1333(a)(2)(A). There are strong policy reasons for the special treatment of these

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[16] Surplus Trading Co. v. Cook, 281 U.S. 647 (1930); Standard Oil Co. v. California, 291 U.S. 242 (1934).

[17] For example, in 1940, Congress passed the Buck Act, 43 U.S.C. §§ 104-110 (1940), which granted the states jurisdiction to levy certain specified taxes within federal enclaves. The act allowed the states to impose their income taxes on persons residing or carrying on business in federal areas within state boundaries. The Buck Act, however, does not extend to the Outer Continental Shelf because language limits its application to "any federal area, or any part thereof, which is located within the exterior boundaries of any State . . . ." 43 U.S.C. § 110. Similarly, Congress granted the states power to tax in the Mineral Leasing Acts, 30 U.S.C. §§ 181-287, and 30 U.S.C. §§ 351-359, but again excluded certain specified lands which included lands beneath marginal seas. 30 U.S.C. § 352. See Justheim v. McKay, 229 F.2d 29 (D.C. Cir.), cert. denied, 351 U.S. 933 (1956).

lands, and there is a long history behind Congress' assertion of absolute federal sovereignty to the exclusion of state taxing authority. Both are relevant here. Logic suggests that the starting point for understanding the history and policy surrounding the Outer Continental Shelf is the legislative history of the state tax prohibition in the OCS Lands Act. The path of the Act through Congress should remove all doubts as to why the Act prohibits taxation of any incident of income or property on the Outer Continental Shelf by any state.

The Act was made necessary by a controversy which arose in 1937 over the rights to submerged lands lying off the coast of the United States. Prior to that time, for all practical purposes, the rights in such submerged lands were assumed to be vested in the adjacent states. The states, in particular California, Louisiana and Texas, had adopted the practice of granting mineral leases both within and without their historic boundaries. When applicants began pressing the federal government for federal leases, the question arose whether the federal government had rights in the submerged lands which were superior to any rights claimed by the states. The battle that grew out of this issue raged for sixteen years, and used as its arena all three branches of the federal government.

In the judicial branch, litigation over the rights to submerged lands was ultimately decided by the Supreme Court of the United States. It found that the federal goverment had paramount right to submerged lands even within the historic boundaries of the states of California, Louisiana, and Texas. United States v. California, 332 U.S. 19 (1947); United States v. Louisiana, 339 U.S. 699 (1950); and United States v. Texas, 339 U.S. 707 (1950).

While the litigation was proceeding, however, there was also extensive activity in the United States Congress. In 1938 and 1939, shortly after the demand for federal leases began, resolutions were introduced before Congress to establish federal rights in the areas of traditional state partnership. See, e.g., S. Rep. No. 133, 83rd Cong., 1st Sess. (1953), reprinted in, 1953 U.S. Code Cong. & Ad. News 1474, 1497-98. Those resolutions failed, and in 1945 Congress attempted to quiet title to the submerged lands in the states. President Truman vetoed that attempt. Id. at 1498. Furthermore, in 1945, President Truman by presidential proclamation (No. 2667, reprinted in 1945 U.S. Code Cong. Service 1199), proclaimed it to be the policy of the United States that the "natural resources of the subsoil and seabed of the continental shelf beneath the high seas but contiguous to the coast of the United States appertain to the United States, subject to its jurisdiction and control." Further attempts by the

congressional representatives from the states of Texas and Louisiana to have the submerged lands quitclaimed to the adjacent states were frustrated by presidential veto. Thus, while the states and the federal government did battle in the federal courts, Congress and the President maintained antagonistic views as to ultimate sovereignty over the Outer Continental Shelf.

A subsequent attempt to deal with the entire controversy involving submerged lands and the Outer Continental Shelf, in favor of the states' rights, was H.R. 4484, 82nd Cong., 1st Sess., Section 8 (1951). That bill permitted the adjacent states to extend police power, including the power of taxation, to the Outer Continental Shelf. This bill was passed by the House on July 30, 1951, but no action was taken by the Senate. Subsequently, the Senate passed S. J. Res. No. 20, 82nd Cong., 1st Sess. (1951), which was equivalent of H.R. 4484 without the Outer Continental Shelf provisions. The bill was vetoed by President Truman on May 29, 1952.

The 82nd Congress having failed to dispose of the Outer Continental Shelf problem, the 83rd Congress turned its hand to the task. With the 1953 advent of the Eisenhower administration, Congress was encouraged to continue its efforts to resolve the Outer Continental Shelf issue and provide the much-needed authority for the orderly development and administration of its mineral rights. Since there was no

existing body of law which applied to the Outer Continental Shelf, and since the attempt to cede that area to the states had failed, the provision of such a body of law was necessary for the orderly governance of then-present and future activities to be conducted on the Outer Continental Shelf.

The initial attempt of the 83rd Congress, H.R. 4198, 83rd Cong., 1st Sess. (1953), applied federal law to the Outer Continental Shelf. As with H.R. 4484 of the prior Congress, the coastal states were permitted to extend laws and police power to the Outer Continental Shelf, but as reported from subcommittee the bill provided that state taxation laws shall not apply to the Outer Continental Shelf. The full committee succumbed to the persuasive abilities of the representatives from Louisiana and Texas and amended H.R. 4198 to contain the following provision for state taxation:

> "State taxation laws within such area shall be limited to severance or production taxes and may be levied only be those states which apply and administer their conservation laws and other State governmental functions in said area: Provided further, That the rate of such severance or production tax shall not be in excess of the rate of said tax within State boundaries."

99 Cong. Rec. at 2569 (1953).

It is clear that at this stage of the Act's development, taxation was only permissible with respect to severance or production taxes -- the result of pressure from coastal states for an exception to general rule that no state

taxation would extend to the Outer Continental Shelf. In an apparent effort to restore the exact language as it originally came out of subcommittee, Rep. Keating of New York offered an amendment which included the following language:

> "State taxation laws shall not apply in such areas of the Outer Continental Shelf. The Secretary shall reimburse the abutting state in the amount of the reasonable costs of administration of such laws."

99 Cong. Rec. at 2571 (1953).

In support of his amendment, Rep. Keating noted that the taxes would necessarily reduce amounts paid for federal leases, and so would fall indirectly on the United States. Id. at 2571. Furthermore, the taxes were more grants than reimbursement, because the Navy and the Coast Guard traditionally policed the area and would most likely continue to do so. The states might incur some out-of-pocket expenses in connection with conservation on the Outer Continental Shelf, but these expenses could be accounted for and, if reasonable, be directly reimbursed. Id. at 2572. The amendment was agreed to and H.R. 4198 was sent to the Senate where Title III of the bill, containing the Outer Continental Shelf provisions, was dropped. The remainder of the bill, Titles I and II, was passed and eventually became the Submerged Lands Act. P.L. 83-31, 67 Stat. 29, May 22, 1953, 43 U.S.C. §§ 1301-1315.

Even before the Submerged Lands Act was passed, the House had incorporated the deleted Title III Outer Continental Shelf provisions in a separate bill, H.R. 5134, 83rd Cong., 1st Sess. (1953), to amend the Submerged Lands Act. 99 Cong. Rec. 4877 (1953). H.R. 5134 contained the Keating amendment that had appeared in H.R. 4198 as well as the provisions extending the laws of the abutting states to the Outer Continental Shelf.

The Senate produced a bill, S. Rep. 1901, 83rd Cong., 1st Sess. (1953), entitled "Outer Continental Shelf Lands Act". It was presented to the Senate in great detail by Senator Cordon of Oregon. He described Section 4 of S. 1901 dealing with the laws applicable to the Outer Continental Shelf as "the heart of the bill legislatively and administratively". 99 Cong. Rec. at 6963 (1953). The laws of abutting states were extended to the Outer Continental Shelf as law to be administered and enforced by the appropriate officers and courts of the United States. The third paragraph of Section 4 of the Act (set out below) was referred to as self-explanatory. "It is the view of the committee that the adoption as federal law of the body of State law of each of the abutting States confers upon such State no legal right of any kind or character". 99 Cong. Rec. 6964 (1953).

The specific prohibition of state taxation contained in H.R. 5134 was not included in S. 1901, but the just-quoted remark of Sentor Cordon and the quote below indicate that the

language codified as 43 U.S.C. § 1333(a)(3) was designed to be an absolute prohibition of the extension of state tax laws to the Outer Continental Shelf.

> "It is the Committee's collective judgment that under the terms S. 1901 as reported, State taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state. Paragraph (3) of Section 4(a) specifically commands that --
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> > The provisions of this section for adoption of the State law as the law of the United States shall never be interpreted as a basis for claiming _any interest_ in or jurisdiction _on behalf of any state for any purpose_ over the seabed and subsoil of the outer Continental Shelf, _or the property and natural resources thereof or the revenues therefrom_." (emphasis added).

S. Rep. No. 411, 83rd Cong., 1st Sess. (1953).

Representatives of the State of Louisiana strongly urged an amendment allowing the extension of state boundaries onto the Outer Continental Shelf, and hence the power to impose state taxes. Senator Cordon argued strongly against such an amendment: "Either the Outer Continental Shelf is territory where the sole jurisdiction, control, and right to tax in any form is in the United States, or it is not." 99 Cong. Rec. at 7234. The Louisiana amendment was rejected. Several other attempts to amend the Outer Continental Shelf Lands Act to allow the abutting states to participate in the revenues therefrom were made by Louisiana and Texas. All were rejected.

Senator Long of Louisiana made a last ditch effort to convince the Senate that the adjacent states were entitled to some compensation, whether through taxation or sharing a part of the revenue. He argued that the services provided Outer Continental Shelf workers must be paid for by increasing current taxes "if the employers of these workers are subject neither to the State's severance tax, property tax, nor tax on corporate profits". (emphasis added) 99 Cong. Rec. at 7261. His argument failed, and the bill went to conference. The bill reported out by the conference was substantially the same as S. 1901 in its application of laws to the Outer Continental Shelf. It added, however, the specific prohibition "State taxtion laws shall not apply to the outer Continental Shelf." That was the form in which the bill became law as the Outer Continental Shelf Lands Act.

Of the two subsections of the OCS Lands Act bill which were intended by Congress to dictate that the states shall not in any form have any economic interest in the Outer Continental Shelf or any revenue therefrom, Section 4(a)(2)(A) (containing the prohibition of state taxation) was language of the House of Representatives. Section 4(a)(3), prohibiting any claim of the states whatsoever to the Outer Continental Shelf, was language of the Senate. The legislative history makes it clear that the latter provision (the Senate provision) was intended to prohibit state taxation on the Outer Continental Shelf. S.

Rep. No. 411, 83rd Cong., 1st Sess. (1953), supra, p. 20-21. It is equally clear that the House of Representatives language was inserted into the Act "in a superabundance of caution" and was agreed to by the Senate conferees when offered by the House conferees. 99 Cong. Rec. 10,471-72 (1953). The losing battle fought by Texas and Louisiana congressmen for an exception to the all-inclusive prohibition on state taxes to allow state severance and production taxes to apply to the Outer Continental Shelf, and the defeat of Senator Long's last ditch argument for some form of tax compensation for perceived economic burdens, conclusively demonstrate that Congress consciously intended that the OCS Lands Act completely prohibit any attempt to extend the reach of any tax law of any state to the Outer Continental Shelf.

The history of this prohibition was paralleled and confirmed in the courts. The basis for special treatment was the nature of the properties involved. The Supreme Court articulated this uniqueness in United States v. Louisiana, 339 U.S. 699, 704 (1950):

> The marginal sea is a national, not a state concern. National interests, national responsibilities, national concerns are involved. The problems of commerce, national defense, relations with other powers, war and peace focus there."

The teaching of history and precedent, therefore, is that income from sales of natural gas on the Outer Continental

Shelf to independent pipeline companies are simply beyond the tax reach of Florida or any other states, as are earnings from the sale or transfer of crude oil on the Outer Continental Shelf. The jurisdictional authority of Florida to tax either sales or transfers has been denied by federal intercession. Whether a third party purchaser acquires the crude oil in a taxable transfer, or whether Shell delivers that crude oil into a pipeline of its own on the platform, the physical activity which takes place on federal sovereign territory is identical.

Congress and the United States Supreme Court have declared unequivocally that federal interests in this international arena bars any state either from increasing the burden on these federally-controlled resources or from reducing the return from leases. The carefully selected and abundantly clear language of Section 1333(a)(2)(A) specifically denies the extension of state taxation, including taxes on revenues, to the Outer Continental Shelf.

Despite federal mandates, the district court held that Florida's income tax law can indeed be applied to the income derived from activities on the Outer Continental Shelf. It is relevant to consider the district court's reasoning, although its articulated analysis consists of only four sentences and offers scant insight into its reasoning.[18] As noted earlier, the court's approach to the issue in the first

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18 9 F.L.W. at 769

instance probably dictated its conclusion.[19] The court merely accepted the department's contention that income is not earned until a product is sold in the United States.

The eventuality of sale is a timing mechanism only. It relates to the realization of income, a tax concept of convenience used to assign income tax measurements to respective twelve month periods. See, Eisner v. Macomber, 252 U.S. 189 (1920). Realization has nothing whatever to do with the source of income production -- a "where" question which is determinative in this case because the OCS Lands Act flatly prohibits any state from taxing income earned on the Outer Continental Shelf.

As if the law were not explicit enough, the department has taken a position which also ignores its own regulations.

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[19]The district court's comparison of sales and income taxes, which suggests the "logic conclusion" of Shell's position, is badly flawed. The court says that Shell's position would preclude the imposition of a sales tax on any product derived from Outer Continental Shelf wells. That is inaccurate. A sales tax is a transaction tax for which consumers bear the direct financial burden. When Saran Wrap (a petroleum - based product) is sold in Florida, a taxable transaction occurs for which the state may collect its due, because the site of the transaction permits a tax levy. Whether some of the petroleum in the Saran Wrap was derived from crude oil under the sea or extracted from under the ground in Texas is immaterial to the levy of a sales tax on the transaction taking place in Florida. Florida's sales tax on Saran Wrap adds no burden to the cost of extracting undersea resources by indirectly increasing Shell's lease payments. A state's income tax, however, is vastly different in concept and incidence from a sales tax, and does impact the amounts Shell will pay for leases to the federal government.

Those regulations prescribe the very tax treatment which Shell has here employed, as regards for products which a taxpayer sells within the United States but produces in whole or in part outside the taxing jurisdiction of Florida. In those situations, the department requires an allocation or apportionment of any income derived from such transactions. Fla. Admin. Code Rule 12C-1.13(1)(b)2b(ii). This regulation sets the method of apportioning that income by reference to Treas. Reg. § 1.863-3(b), relating to income partly from sources in a foreign country. The method directed requires the use of an established fair and independent production price where no sales price is available,[20] which is precisely what Shell has done in computing its excludable income to Florida. Shell utilizes fair market value wellhead prices to determine the amounts earned from crude oil produced outside the taxing jurisdiction of Florida on the Outer Continental Shelf in situations where no actual sale has occurred.[21]

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[20]Treas. Reg. § 1.863-3(b)(2), Example (1).

[21]It is irrelevant to this principle, of course, that the grounding for this regulation was Florida's policy choice not to tax income derived from foreign sources. The reasoning pertains no less to a tax inhibition imposed by the Constitution and federal law.

Conclusion

Through the OCS Lands Act, the United States government has declared as national policy that no state may extend its taxing reach onto the Outer Continental Shelf. In section 220.05, the Florida Legislature has declared that it has no intention of doing what the supremacy clause of the United States Constitution or Congress has expressly forbid. The department, however, seeks to tax income earned by Shell on the Outer Continental Shelf. Since the taxation of that income is absolutely barred, the department's position must be rejected and the district court's decision reversed.

At whatever time income may be deemed realized for federal and Florida income tax purposes, if the income is not taxable at all then the state may not impose its levy. The time at which income is appropriately reportable for tax accounting purposes is irrelevant if the income is itself immune from taxation. The district court mistakenly held that the advent of selling refined petroleum product -- a timing issue -- governs the permissibility of taxing earnings from the transfer or sale of un-processed oil and gas in a geographical area entirely governed by federal interests. Federal statutory and constitutional directives say the state may not tax these earnings. Accordingly, the question framed by Shell should be answered in the affirmative, and the district court's decision should be quashed.

Certificate of Service

I certify that a true and correct copy of this brief was mailed on March 4, 1985 to Joseph C. Mellichamp, III, Esq., Assistant Attorney General, Department of Legal Affairs, The Capitol, Tallahassee, Florida 32301, counsel for the Department of Revenue.

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