1-1-1971

Taxation of Mineral Interests under Article XII, Section 3 of the Montana State Constitution

Harold V. Dye

Follow this and additional works at: https://scholarship.law.umt.edu/mlr

Part of the Law Commons

Recommended Citation
Available at: https://scholarship.law.umt.edu/mlr/vol32/iss1/3

This Comment is brought to you for free and open access by The Scholarly Forum @ Montana Law. It has been accepted for inclusion in Montana Law Review by an authorized editor of The Scholarly Forum @ Montana Law.
COMMENTS

TAXATION OF MINERAL INTERESTS UNDER ARTICLE XII, SECTION 3 OF THE MONTANA STATE CONSTITUTION

All mines and mining claims, both placer and rock in place, containing or bearing gold, silver, copper, lead, coal or other valuable mineral deposits, after purchase thereof from the United States, shall be taxed at the price paid the United States therefor, unless the surface ground, or some part thereof, of such mine or claim, is used for other than mining purposes, and has a separate and independent value for such other purposes, in which case said surface ground, or any part thereof, so used for other than mining purposes, shall be taxed at its value for such other purposes, as provided by law; and all machinery used in mining, and all property and surface improvements upon or appurtenant to mines and mining claims which have a value separate and independent of such mines or mining claims, and the annual net proceeds of all mines and mining claims shall be taxed as provided by law. MONTANA CONSTITUTION, ARTICLE XII, SECTION 3.

INTRODUCTION

The method in which the Montana Supreme Court has dealt with Article XII, Section 3 of the Montana Constitution presents what may be termed a classic case of state constitutional interpretation. Most of the obvious questions concerning the various facets of Section 3 have been answered in one form or another over the years, and by this process an underlying rationale or theory of that section's operation has been developed. This process has not been entirely clearcut, however, and much of the language in the various opinions is inconsistent both with other opinions and with the underlying theory itself.

In part at least, this state of affairs is explainable by the fact that the theory was developed through a process of case by case adjudication. There is a natural and human tendency on the part of judges to tailor the language of their opinions to fit the facts of the case before them. When the facts are changed, an apparent conflict arises between the exact "holding" and the literal language of the opinion. This tendency is heightened where, as here, a significant percentage of the case law arose from a single county—Musselshell—and involved many of the same parties.

1Hereinafter textually referred to as Section 3. This provision is enacted substantially verbatim as Revised Codes of Montana, § 84-5401 (1947) [hereinafter cited R.C.M. 1947 § 84-5401; earlier compilations will be cited by date].
The purpose of this article is to attempt to highlight the consistent language of the various cases and attempt to develop and expand upon the theory of that section as it has been construed by the case law.

**HISTORICAL ANTECEDENTS**

A brief review of the territorial legislation concerning the taxation of mineral interests will be helpful in analyzing Section 3 and in understanding the case law construing it. At all times it should be borne in mind that mining occupied a paramount position in the eco-political structure of the Territory from and prior to its inception.

The first legislation on the subject was contained in the Bannack Statutes of 1864-65. That act specifically exempted "mining claims" from taxation and provided that "all machinery used in mining claims, and all property and improvements appurtenant to or upon mining claims, which have an independent and separate value, shall be subject to tax."

This provision was later amended to exempt "mines and mining claims" and still later to exempt "mines and mining claims except those held under a patent from the United States."

In 1879, a net proceeds tax was imposed on persons "... engaged in mining upon a quartz vein or lode, or placer mining claim containing gold, silver, copper or lead."

Section 5 of that act provided that

... no direct tax shall be levied upon any placer claim, quartz lead, or lode, except to the extent of the price paid for the mining claim in obtaining patent therefor from the government of the United States, and the only taxation of the proceeds thereof shall be that provided in this act: Provided, that this act shall not be so construed as to exempt from taxation improvements consisting of buildings, erections, or machinery placed upon any quartz lead or lode, or used in connection therewith.

The final step was to exempt

Mines, except on the net proceeds thereof, and mining claims, except those held under a patent from the United States, the surface of which shall be taxed as other real estate, Provided, That all machinery used in mining claims, and all property and improvements appurtenant or upon mining claims, which have a separate and independent value, shall be subject to taxes.

The Act of February 21, 1879, remained in full force as Sections 1791 to 1795 inclusive of the Compiled Statutes of 1887.

This was the state of the law of mining taxation in Montana at the time the Constitutional Convention met in 1889. The debates of that Con-

---

2 Act of Feb. 7, 1865 (Bannack Stats. of 1864-65 at 412).
5 Act of Feb. 21, 1879 (Mont. Terr. Leg., 11th Sess. at 65).
6 Id at 67.
vention,8 as well as the text of Section 3 itself, make it clear that it intended to incorporate the law relative to mining taxation into the Constitution.

THE SCOPE OF SECTION 3

From the above, it is possible to make certain preliminary observations concerning Section 3. The first is that the language of that section was directed primarily at the type of mining prevalent at the time of its adoption,9 e.g. gold, silver and copper mining. This has caused some problems in the past and holds the potential for causing more in the future.10 For example, it was necessary to resort to litigation to determine that coal mining was within the contemplation of Section 3 even though it was specifically enumerated therein, because coal mining is technically neither "placer" nor "rock in place."11

A second observation is that while Section 3 was adopted primarily to benefit the mining industry,12 its purpose was not to exempt such property from taxation.13 Rather, when that section is read in conjunction with the other sections of Article XII14 and in light of the territorial legislation on the subject,15 it is apparent that it is in fact a revenue measure.16

The specific evil at which Section 3 was directed is the ad valorem taxation of mineral deposits in situ.17 It was felt that the accurate estimation of undeveloped mineral wealth in place was an impossible task18 and that such a system would leave the valuation of such property up to the predilections of individual assessors.19 It was also felt, perhaps not

---

8State of Montana, Proceedings and Debates of the Constitutional Convention, 470-9, 492-7 (1921).
10For example, see the discussion below under the heading Taxation of Oil and Gas Interests.
11Montana Coal and Coke Co. v. Livingston, 21 Mont. 59, 68, 52 P. 780, 781 (1898).
12Kipp v. Davis-Daly Copper Co., 41 Mont. 509, 519, 110 P. 237, 241 (1910). However, Section 3 has not always had the intended effect. See, e.g., Musselshell County v. Morris Development Co., 92 Mont. 201, 209, 11 P.2d 774, 777 (1932) (mining claim to be taxed at price paid the United States even though minerals thereon were exhausted); State ex rel. Hinz v. Moody, 71 Mont. 473, 485, 230 P. 575, 580 (1924) (mining claims cannot be assessed at any classification less than 100% of the price paid the United States).
14Especially §§ 1 (providing that the legislature shall provide the necessary money for support and maintenance of the state), 2 (providing what property may be exempted from taxation), and 16 (which provides that "all property shall be assessed in the manner provided by law except as otherwise provided in this constitution").
15Discussed above under the heading Historical Antecedents.
16Mjelde, supra note 13 at 297, 137 P. at 389; Barnard Realty Co. v. City of Butte, 50 Mont. 159, 164, 145 P. 946, 948 (1916).
17Northern Pac. Ry. v. Musselshell County, 54 Mont. 96, 105, 169 P. 53, 55 (1913); Hinz, supra note 9 at 511, 267 P. at 1116.
19Northern Pac. Ry. v. Musselshell County, supra note 17 at 106, 169 P. at 56.
without justification, that such a system would place an undue burden on the development of the state's mineral resources.\textsuperscript{20}

At the same time, this desire to assist the mining industry was balanced by the opinion that that industry must be made to "respond to the reasonable demands of the state for revenue."\textsuperscript{21} In order to resolve these somewhat conflicting goals, a rather complicated scheme was worked out. As a first step, the value of "mines and mining claims" purchased as such\textsuperscript{22} from the United States is arbitrarily\textsuperscript{23} set at the price for which the land was purchased.\textsuperscript{24} So long as the mining property remains in its undeveloped state, this is the only tax levied on the owner.

Once the property is developed, the owner is required to pay, in addition, property taxes on the machinery used in the operation\textsuperscript{25} and a net proceeds tax on the mineral wealth as it is severed\textsuperscript{26} Finally, if the owner uses the surface of the property\textsuperscript{27} or any improvements thereon\textsuperscript{28} for some purpose other than mining, he is required to pay \textit{ad valorem} taxes on the property based on its value for such other purposes.\textsuperscript{29}

It seems safe to assume that the Constitutional Convention had in mind the various programs, then in effect, under which a person could obtain title or right of possession to mineral lands at no cost or at a nominal price per acre which did not reflect the potential mineral value of any particular tract.\textsuperscript{30} It may also be assumed that it was felt that land containing potential mineral wealth which was acquired under some other program for the disposal of Federal lands, \textit{e.g.} the Homestead Act, would pay \textit{ad valorem} taxes on its value for other purposes and would thereby contribute to State revenue.\textsuperscript{31}

"...mines and mining claims. . ."

Section 3 speaks only in terms of "mines" and "mining claims." After some initial struggle,\textsuperscript{32} it was determined that Section 3 applies to all mineral deposits\textsuperscript{33} in the state and not merely to "mines" and "mining claims."\textsuperscript{34} In other words, the purpose of that section is to for-
bid the taxation of mineral deposits in situ\textsuperscript{35} and allow taxation of them only in the form of a net proceeds tax.\textsuperscript{36}

Notwithstanding this, the judicial definitions of what constitutes a "mine" or "mining claim" have been worked out at some length by the Montana Supreme Court and are important both intrinsically and as a guide toward understanding the theory of Section 3.

A "mine" within the contemplation of Section 3 is developed mining property yielding, or capable of yielding, revenue.\textsuperscript{37} An undeveloped or undiscovered mineral deposit is not a "mine."\textsuperscript{38} The term refers to the extraction and recovery of virgin ore. Thus, a plant for the recovery of ore from a visible and distinct tailings dump is not a "mine"\textsuperscript{39} but is subject to \textit{ad valorem} taxation as personal property.\textsuperscript{40}

A "mine" is not necessarily a single shaft\textsuperscript{41} but may consist of extensive mineral workings. Whether or not an operation is one "mine" depends on such factors as unity of ownership, relative location, and integration of operation and management.\textsuperscript{42} The character of the legislation, under which a developed mine is acquired, is irrelevant.\textsuperscript{43} It is subject to tax on its net proceeds whether the land was acquired as mineral lands, under the Homestead Act, or as part of a grant to a railroad.

In contrast to a "mine," the source of the original grant from the United States is all important for a "mining claim." A "mining claim" is a "... tract of land to which the right of possession or the title has been acquired pursuant to the Acts of the Congress relating to the disposition of mineral lands."\textsuperscript{44} So long as such a claim remains in private
ownership, it retains its character as a "mining claim."45 and neither any act of the owner46 nor a judicial finding47 that the mineral reserves are exhausted will serve to alter the character of the claim or reduce its value for tax purposes.

Initially, the owner of a "mining claim" owns everything from the surface of the land to the center of the earth, except for such rights as are reserved by the Federal Government.48 Like the concept of title in fee simple, the term "mining claim" is a term embracing a collection of many rights. The tax on a "mining claim" is a tax on the whole of these rights49 and not merely a substitute for ad valorem taxation of the surface50 or a tax on the minerals in situ.51

It has never been authoritatively determined whether it is possible to divide a "mining claim" by horizontal, as distinguished from vertical, severance of the claim. In Superior Coal Co. v. Musselshell County52 it was held that where a person sells the surface rights to land constituting a "mining claim," reserving the mineral rights and the right to use of the surface for exploration and mining purposes, he retains the "mining claim" in toto and is to be assessed on its entire value.53 That decision was based on the theory that the owner, by devoting the surface of the "mining claim" to a separate and independent use, in effect, creates a new taxable estate in the surface.54 The selling of this separate estate was held not to affect the ownership of the "mining claim" itself.55

"Mining claims" are taxable at the price paid the United States.56 This value is "fixed and immutable,"57 and the taxing authorities are without power to find that the land is no longer a mining claim58 or to classify the property in such a way that it is assessed at less than 100 percent of the price paid the United States.59 The taxation of "mining claims" at this arbitrary valuation60 is part of a comprehensive scheme to compel mine operators to pay their fair share of the cost of government, while avoiding the evil of ad valorem taxation of minerals in place.61

46 Superior Coal Co., supra note 23 at 514, 41 P.2d at 20.
48 Superior Coal Co., supra note 23 at 518, 41 P.2d at 22.
49 Id. at 517, 41 P.2d at 21.
50 Morris Development Co., supra note 12 at 207, 11 P.2d at 776.
51 Id. at 208, 11 P.2d at 776.
52 Superior Coal Co., supra note 23.
53 Id. at 516-7, 522, 41 P.2d at 21, 23.
54 Id. at 519, 41 P.2d at 22.
55 Id. at 521, 41 P.2d at 23.
56 Id. at 515, 41 P.2d at 20.
57 Morris Development Co., supra note 12 at 208, 11 P.2d at 776.
58 Id. at 209, 11 P.2d at 777.
60 Hinz, supra note 9 at 510, 267 P. at 1115-6.
61 Mjelde, supra note 13 at 296, 137 P. at 388.
As such, it has been held not to constitute a deprivation of due process or equal protection under the Fourteenth Amendment to the United States Constitution.

As was stated above, the tax is on the mining claim as a whole and not merely on the surface. It follows then that the value of the surface for some separate and independent use cannot become the value of the "mining claim" even if all the minerals thereon are exhausted.

In summary, it appears that the Montana Supreme Court has drawn a dichotomy between "mines" and "mining claims," notwithstanding the literal language of Section 3 which couples the two words together. The former is related to the final clause of Section 3, which imposes a net proceeds tax, while the latter apparently applies only to that clause which provides that such property shall be taxed at the price paid the United States.

As a practical matter, this distinction probably makes little difference since an undeveloped mining claim would obviously have no net proceeds to tax and the vast majority of mineral lands were sold by the United States without taking the potential mineral wealth into account in the selling price. A problem might arise, however, if a person purchased developed mining property from the United States at a price which reflected the apparent value of the mineral wealth in place. By the literal language of Section 3, such property would be subject to tax at that price (which would, of course, reflect the value of the minerals in situ) and on the net proceeds of the mine. Such a circumstance would almost certainly lead to litigation and would force the Supreme Court to re-examine the incongruities of its previous holdings, as well as raising severe equal protection questions. However, to this date, the problem has not formally presented itself.

"... UNLESS THE SURFACE GROUND . . . IS USED FOR OTHER THAN MINING PURPOSES. . . ."

From the above, it is possible to deduce the principles surrounding the operation of the "surface clause" of Section 3. As noted above, a "mining claim" is arbitrarily taxed at the price paid the United States in order that the claim contribute something to the revenues of the state. The tax is on the claim as a whole, and not merely on the surface rights. It is presumed that the surface is of value only in extracting the minerals.

---

*Superior Coal Co., supra note 23 at 523, 41 P.2d at 24.
*Id.
*Hinz, supra note 9 at 511, 267 P. at 1116.
*Superior Coal Co., supra note 23 at 521, 41 P.2d at 22.
When the owner of a claim devotes the surface to a separate and independent use, he has in effect created a new taxable estate which is taxable at its value for such independent use. This tax is in addition to, and not in lieu of, the constitutional tax on the "mining claim." The word "surface" as used in Section 3 refers to the superficial part of the land. In order for the tax to be imposed, it is not necessary for the surface use to be any more extensive than proper uses require, for example, for grazing, agricultural, or townsite purposes.

Before the surface may be taxed, two conditions must be met. First, the land must have a value for purposes separate and independent from mining. Second, the land must actually be used for such other purposes. In other words, the fact that the surface of a "mining claim" may have a high potential or speculative value for other purposes, e.g. for townsite purposes, will not cause the claim to be taxed on its value for such other purposes unless it is actually so used. However, substance controls over form, and if the surface is actually used for other purposes, it will be subject to tax, notwithstanding pretenses to the contrary. The burden of establishing a separate and independent use lies with the taxing authorities.

"... ALL MACHINERY USED IN MINING, AND ALL PROPERTY OR SURFACE IMPROVEMENTS...."

Section 3 sets up a double standard for machinery used in mining and improvements or other physical additions to mines and mining claims. The machinery is subject to ad valorem taxation as is other personal property. Improvements and additions, on the other hand, are totally exempted from taxation so long as they are used only for mining purposes.

In Hale v. Jefferson County it was held that a standard similar to that governing the assessment of the surface of a mining claim is to be used in assessing improvements to mining property. That is, in order for the improvements to be taxed, they must have both a separate and independent value and actually be used for other than mining purposes.

It should be noted at this point that such a decision was not required of the court by the literal language of Section 3. That section states that the surface ground shall be taxed if it "...is used for other

---

Barnard Realty Co., supra note 16 at 164, 154 P. at 948.
Id., 154 P. at 947.
Hinz, supra note 9 at 510, 267 P. at 1115 (overruling on this point Northern Pac. Ry. v. Musselshell County, supra note 17 at 113, 159 P. at 58).
Superior Coal Co., supra note 23 at 518, 41 P.2d at 22.
Id.
Barnard Realty Co., supra note 16 at 164, 154 P. at 948.
Id.
Barnard Realty Co., supra note 16 at 164, 154 P. at 948.
Hale, supra note 28 at 143, 101 P. at 976 (mining ditch which had a potential separate and independent value as irrigation ditch, but not used as such, held not subject to tax).

https://scholarship.law.umontana.edu/mlr/vol32/iss1/3
than mining purposes, and has a separate and independent value. . . . 
[emphasis supplied]. It only requires that improvements be taxed if they have a value "separate and independent of such mine or mining claim."78

". . . THE ANNUAL NET PROCEEDS . . . SHALL BE TAXED AS PROVIDED BY LAW."

As previously noted, a net proceeds tax79 is imposed on mines in lieu of ad valorem taxation of their mineral deposits. This tax should be carefully distinguished from the gross proceeds tax on mines.80 The latter is a license tax, imposed for the privilege of doing business in the state, and has a different constitutional basis entirely.81

The net proceeds tax is imposed on any person extracting from a mine or tailings dump82 precious stones or valuable minerals, including oil and gas.83 Such a person must file a verified statement of gross yield with the State Board of Equalization.84 The statement must contain the quantity of minerals extracted, the gross yield in dollars and cents,85 and the actual cost of extraction, reduction, transportation and sale.86 In addition, the statement must show the amounts of royalties owing or claimed and the persons who are entitled to or claim them; the cost of construction, repairs, and betterments to mines and the cost of repairs and replacements to reduction works; the assessed valuation of such reduction works; and the actual cost of fire and workman’s compensation insurance coverage.87

From this statement the State Board of Equalization computes the amount of net proceeds.88 This is done by deducting from the amount of gross yield the actual cost of royalties; extraction, reduction, transportation and sale of the ore; workman’s compensation and fire insurance

---

78 It is interesting to note the legislative response to the decision in Hale, supra note 28. R.C.M. 1947, § 84-5403 provides in pertinent part that:
No moneys invested in mines or improvements shall be allowed as a deduction [in computing net proceeds] unless all machinery equipment and buildings represented by such moneys shall be returned to the county assessor of the county in which such mine is located for assessment purposes, at the level of assessment of all other property in such county.

79 The relevant provisions may be found in R.C.M. 1947, §§ 84-5401 through 84-5415.
81 Mont. Const. art. XII, § 1.
82 But see, discussion, supra note 40.
83 R.C.M. 1947, § 84-5402.
84 Id. See also Butte & Superior Mining Co. v. McIntyre, 71 Mont. 254, 260, 229 P. 730, 732 (1924) (Constitution does not designate which officer is to collect the net proceeds tax and therefore the legislature may vest this power in the State Board of Equalization).
85 This gross yield includes any bonus or premium paid for mining over and above the amount received for the minerals based on a standard market price. Minerals Engineering Co. v. Greene, 131 Mont. 119, 128, 308 P.2d 977, 981 (1957). Greene expressly overruled the earlier decision of Kliez v. Linnane, 117 Mont. 59, 63, 155 P.2d 183, 186 (1945) which had held that such a bonus or premium was not a part of the gross yield.
86 R.C.M. 1947, § 84-5402.
87 Id.
88 R.C.M. 1947, § 84-5403.
payments; and repairs and replacements of the reduction works. In addition, depreciation on the reduction works is allowed at the rate of six percent of the assessed valuation of the works. Finally, ten percent of the cost of improvements, betterments and repairs to the mine, incurred in the current year, is deducted along with ten percent of such costs incurred in each of the preceding nine years.

No expenses may be deducted except those provided for in the statute and, more particularly, no salaries may be deducted except for those persons working the mine or superintending its management. Nor may the net proceeds for any one year be averaged so as to include losses from previous years.

After the computation of net proceeds is completed, the State Board of Equalization proceeds to assess any royalties paid or claimed. The assessment is made from the list of royalties in the verified statement. It is then sent to the county where the mine is located along with the computation of the mine's net proceeds. All royalties, except those on oil and gas, are taxed as personal property, while the net proceeds are separately assessed as "net proceeds of mines." Both net proceeds and royalties are classified at 100 percent of their full cash value.

If a person fails to file a verified statement, the State Board of Equalization may proceed to estimate the amount of net proceeds. To aid in this task, it possesses the power of subpoena. In addition, the Board possesses the power to examine the books and records or the mine operator to verify the correctness of the assessment.

The tax as assessed constitutes a lien on the mine involved, or at least on the operator's interest therein, and on the buildings and equipment used in the operation. The lien may be enforced by either summary proceedings or summary attachment.

---

89Id.
90Id.
91Id.
92E.g., Anaconda Copper Mining Co. v. Junod, 71 Mont. 132, 138, 227 P. 1001, 1003 (1924) (taxes and insurance may not be deducted from gross yield to compute net proceeds).
93R.C.M.1947 § 84-5403.
94State ex rel. Roberts v. State Board of Equalization, 138 Mont. 142, 355 P.2d 150, 152 (1960) (provision in R.C.M.1947, § 84-5408 prescribing such averaging held contrary to Section 3 which imposes a tax on the annual net proceeds of mines).
95R.C.M.1947, § 84-5406.
96Id.
97R.C.M.1947, § 84-5409.
98Id.
99Id.
100R.C.M.1947, §§ 84-301, 84-302 (net proceeds), 84-5406 (royalties). Note also that the value of a right of entry (discussed below) is also placed in this classification.
101R.C.M.1947, § 84-5410.
102Id.
103R.C.M.1947, § 84-5412.
104R.C.M.1947, §§ 84-5405, 84-5413. The former section reads as follows:
The tax so assessed on net proceeds shall be and shall constitute a lien upon all the right, title and interest of such operator in or to such mine or mining claim and upon all of the right, title and interest in or to the machinery, buildings, tools and equipment used in operating said mine or mining claim.
seizure and sale or court action, as in the case of the enforcement of other
tax liens.\textsuperscript{106}

**TAXATION OF OIL AND GAS INTERESTS**

Up to this point the text of Section 3, its construing case law, and
the legislation implementing it have been presented as an integrated
whole. To a large extent this is true. While there has been some incon-
sistency in the language of the various decisions in the areas heretofore
discussed, the net effect has been an internally consistent theory which
is harmonic with both statutes and Constitution. This most certainly can-
ot be said of the taxation of oil and gas interests and "rights of entry,"
the matters considered under this and the following headings.

At a glance, it would seem that oil and gas interests would be within
the contemplation of Section 3 and therefore taxable in the same man-
ner as are other mineral interests. True, the Constitutional Convention
probably did not even consider the potential petroleum wealth in the
state, but the language they used, "or other valuable mineral deposits,"
is reasonably susceptible to the construction that its scope would include
all mineral deposits, whether known or unknown at the time of the
Convention.

The Legislative Assembly undoubtedly thought that such was the
case when it amended the net proceeds statutes to tax oil and gas wells.\textsuperscript{107}
In addition, dicta from a number of Montana cases seem to assume that
an oil well is a "mine" within the contemplation of Section 3 or, at least,
that an oil well is within that Section's contemplation.\textsuperscript{107}

Perhaps there would be no question of the applicability of Section 3
except for the case of *Rist v. Toole County*.\textsuperscript{108} In *Rist* the defendant
county assessed the property in question at a value which reflected the
probable future oil and gas production.\textsuperscript{109} In other words, the oil and
gas in place were taxed.

\begin{footnotesize}
\begin{enumerate}
\item It was enacted as *Laws of Montana* ch. 161, § 4 (1933). Section 84-5413 reads, in
pertinent part:
The taxes on such net proceeds must be levied as the levy of other taxes are pro-
vided for, and every such tax is a lien upon the mine or mining claim from which
the ore or mineral products or deposits are mined or extracted, and is a prior lien
upon all personal property and improvements used in the process of extracting such
ore or mineral products or deposits; provided, however, that such personal or real
property is owned by or under lease by the person, partnership, association, or
corporation who extracted said ore, or mineral products or deposits.

It was last amended in 1925 and has, of course, never been repealed. The reader is
invited to ponder the differences between the two sections, if any, and to reflect upon
the present state of the law in Montana.

\item *R.C.M.1947*, § 84-5413.

\item *Laws of Montana* ch. 139, § 1 (1927).

\item *Forbes v. Mid-Northern Oil Co.*, 100 Mont. 10, 13, 45 P.2d 673, 675 (1935); *Byrne
v. Fulton Oil Co.*, 85 Mont. 329, 334-5, 278 P. 514, 517 (1929); *Homestead Explora-

\item *Rist v. Toole County*, 117 Mont. 426, 159 P.2d 340 (1945).

\item *Id.* at 430, 159 P.2d at 341.
\end{enumerate}
\end{footnotesize}
Rist did not squarely hold that oil and gas interests were subject to ad valorem taxation. Rather, it was decided on the standing issue that the plaintiff, as a mere holder of a royalty interest, could not sue to enjoin the issuance of a tax deed but was limited to redeeming the property. However, there was not the slightest intimation, except in the dissent, that the assessment was in any way improper. And any possible misimpression caused by that case has not been corrected since.

If other counties follow the example of Toole County, encouraged by the omissions of Rist, a most difficult situation would arise. The oil and gas would be taxed in situ. At the same time, the net proceeds of the wells would be taxed under Chapter 54 of Title 84, R.C.M. Since the net proceeds tax is in lieu of, and not in addition to, ad valorem taxation, this form of double taxation is almost certainly a violation of the Equal Protection Clause of the Fourteenth Amendment.

The writer must confess that he does not know whether or not this is the current practice of any county, but would suspect that if the situation ever amounted to double taxation per se, counsel for the oil industry would certainly rectify it. It is still possible, however, that undeveloped oil and gas in place is being taxed. At least, the potential for such action exists and will continue to exist until the misimpressions of Rist are corrected.

TAXATION OF "RIGHTS OF ENTRY"

If Rist can be considered a mere judicial aberration, without current practical effect, the same cannot be said of the decisions concerning "rights of entry." The litigation over the taxability of this rather obscure property right has been relatively extensive. Yet, the body of law which has developed is self-contradictory and inconsistent with the larger purposes of Section 3, almost to the point of being arbitrary and capricious.

A "right of entry" is the right to enter land to explore for minerals and to extract the same where found. It is an incorporeal hereditament to land and is to be distinguished from the corporeal hereditament of the minerals in place.

The tax on the right was, in the first instance, judge made. In Northern Pacific Ry. v. Musselshell County, the court had under consideration the taxability of certain land which the plaintiff railway had sold reserving mineral rights and the right to enter the surface for the purposes of exploring for and extracting minerals. A tax imposed on the

111Id. at 442, 159 P.2d at 346.
112Id. at 443, 159 P.2d at 346.
113Northern Pac. Ry., supra note 17.
114Northern Pac. Ry. v. Musselshell County, supra note 17 at 112, 169 P. at 58.
115Id.; Hinz, supra note 9 at 512, 267 P. at 1116. Cf. R.C.M.1947, § 67-601 which defines the right to take minerals from land as a servitude which may be attached to other land in the form of an easement.
116Northern Pac. Ry., supra note 17.
right of entry was upheld on the grounds that as a mere incorporeal hereditament it was distinguishable from the minerals in place and, since the right was presumably valuable, it was taxable under the general provision that all property in the state, not exempt, is subject to taxation. The validity of such a tax has been repeatedly upheld by the Montana Supreme Court.

In 1921 the tax classification statute was amended to explicitly tax reserved rights of entry and to place them in the 100 percent classification, along with the net proceeds of mines. In the absence of satisfactory legislative history, it is difficult to determine the exact intent of the Legislative Assembly in passing this amendment. It might well have been merely to codify the Northern Pacific Ry. case, or it might have been to change the holding of that case that rights of entry were to be taxed "as an interest in reality." It is clear, however, that there is not the slightest intimation, either in the text of the statute or in the circumstances surrounding its passage, to exempt non-reserved rights of entry from taxation or to modify the general statute providing for taxation of all property in the state not exempt.

Nevertheless, in Cranston v. Musselshell County the court unanimously held that a conveyed, as distinguished from a reserved, right of entry was not subject to tax. The grounds for the court's decision are somewhat obscure. Mention was made of the fact that R.C.M. 84-301 and the Northern Pacific Ry. case, by their express terms, applied only to reserved rights of entry. The court then discussed Hale v. Jefferson County and held that an easement for a right of entry like an easement for the mining ditch involved in that case "have no value independent of the dominant estate they serve."

The opinion's final paragraphs hold that historically a distinction was recognized between reserved and conveyed rights of entry, with the former constituting a distinct taxable estate, and that therefore a conveyed right of entry could not constitutionally be taxed. No mention

117 Id.; Anaconda Copper Mining Co. v. Ravalli County, 52 Mont. 422, 425, 158 P. 682, 683 (1913); Hinz, supra note 9 at 512, 267 P. at 1116; Lehfeldt v. Adams, 130 Mont. 395, 398, 303 P.2d 934, 936 (1956).
118 Laws of Montana ch. 51, § 1 (1919) (now R.C.M. 84-301 in modified form).
119 Laws of Montana ch. 248, § 1 (1921).
120 Northern Pac. Ry., supra note 17 at 112, 169 P. at 58. Under the then existing classification statute an "interest in reality" would probably be classified as land and assessed at 30% of its true and fair value. Laws of Montana ch. 54, §§ 1, 2 (1919).
121 But see, Mont. Const. art. XII, § 2.
124 Id. at 681.
125 Id. at 678-9.
126 Hale, supra note 28.
127 Cranston, supra note 124 at 681.
128 Id.
was made in the opinion of either Article XII, Section 2, which enumerates the types of property which may be exempted from taxation, or of R.C.M. 84-201, which states that all property in the state, not exempt, is to be taxed.

The value of the "right of entry" is to be deducted from the separate and independent value of the surface in determining the taxable valuation of the latter.\textsuperscript{130} It is not an element of the value of a "mining claim," and, if such a right is reserved, the owner of the claim is to be taxed on the value of the reservation in addition to the tax on the claim as such.\textsuperscript{131}

If the subtleties of the court's reasoning escape the reader, he is not alone. Under the current state of Montana law, if a person is granted a right of entry, it is not taxable in any event. Yet, if an owner of a "mining claim" conveys away the surface and reserves such a right, he must pay taxes on both the claim and the right. Since the value of this right is to be deducted from the separate and independent value of the surface and not from the taxable value of the "mining claim,"\textsuperscript{132} it must be that such a right forms an element of the separate and independent value of the surface. Yet, how the right to explore for and extract minerals can be separate and independent of a mining claim baffles the imagination.

The problem seems to be that the court has been dogmatically trying to answer the question of whether a right of entry is constitutionally taxable, without first determining the preliminary question of whether, on the facts of the particular case, the value of the right is in fact separate and independent of the "mining claim" or minerals in place, as the case may be.

It is necessary for this determination to realize that a right of entry has the capability of being either dependent on or independent of the underlying mineral wealth. After all, such a right is a mere \textit{profit a prente}, which is not the same as the corporeal hereditament of the minerals in place. It is possible for a landowner to grant to another the right to enter his land, explore for minerals and extract them where found for, say, a period of years. No one would dispute that the grantor still owned the minerals in place nor that the grantee owned a property right which could turn out to be very valuable.

Once this essential realization is made, the question of the taxability of rights of entry becomes merely one of setting limits. It might be that only a non-exclusive right of entry, \textit{e.g.} one which is not connected to any mineral rights, possesses sufficient "separate and independent value"
to be subject to tax. Or, the line might be drawn between rights which are attached to "mining claims" and those which are attached to mere mineral rights. But whatever the decision, it is essential that the court correct the present state of affairs, and do it as soon as possible.

**CONCLUSION:**

**THE VALUE OF SECTION 3**

In writing this article, I have attempted to avoid commenting on the social, political, or legal wisdom of Section 3 as a whole, as distinguished from the particular cases construing it. The former have been reserved for this heading.

The fact that Section 3 was adopted primarily to benefit an industry which, at least in the past, has had a disproportionately large voice in the government of this state, should not blind one's eyes to the fact that that Section is an attempt, however crude, to deal with the unique economic characteristics of mineral exploitation. In order to place these remarks in perspective, it is necessary to briefly detail these characteristics.

The first and most important of these is that ultimately the value of a mineral right is a derived value. That is, the value of the right to mine minerals is derived from the value of the minerals themselves. And minerals are of economic use to society only to the extent that they are severed from the earth and made available for production.

It follows that any value placed on undeveloped mineral resources is essentially speculative. Such value is dependent on such factors as the estimated quantity of minerals, the technological and economic feasibility of mining them, and the market price of the minerals as severed. It need only be added that a change in any one of these factors will change the value placed on the mineral right. In addition, minerals are depletible resources. This is important for two reasons. First, as a practical matter, the full fair market value of mining property is never utilized in any one taxable period. Second, assuming all other factors remain equal, the fair market value of mining property will tend to decrease as the minerals contained in it are extracted.

In evaluating any tax used as a revenue source, as distinguished from a tax used as a regulatory device, several criteria have traditionally been used. Among these are the tax's inherent fairness, its effect on the underlying revenue base, the relative stability or dependability of revenue collection, and the ease of administration of the tax. When the economic characteristics of mineral exploitation are evaluated in light of these criteria, it becomes clear that some form of proceeds tax is far superior to the *ad valorem* taxation of minerals in place.

First, a proceeds tax tends to be fairer because it taxes the real economic interest involved; that is, the minerals as severed. The fair market
value of the minerals in place, to a large extent, reflects only potential real economic wealth. If this potential value were assessed, at any reasonable classification percentage, it would constitute an obstacle to the further development of the state's mineral resources, unless some form of tax relief were made available to the mining industry. This is because the taxes due for the initial years of development would amount to a prohibitively high percentage of the value of the minerals extracted.133

This situation would not continue indefinitely, however. As the minerals are extracted, the assessed value of the property, and therefore the tax revenues of the state and its subdivisions, would decrease.134 In fact, the amount of taxes due would tend to vary inversely with the quantity of minerals extracted.135 Obviously, such an inducement to maximize production would not contribute to the wise consumption of depletiable natural resources. By contrast, the tax revenues from a proceeds tax vary directly with production. The mine operator is not tempted to maximize production merely to minimize his property taxes. While the government cannot be assured of constantly increasing (or even stable)

Assume the following facts: mining land with a fair market value of $1,000,000 is to be taxed on its ad valorem value and that it is to be classified with other land at 30% of its fair and true value. Assume further that minerals worth $100,000 would be produced each year for ten years, at which time the land would become worthless. Then given a total millage levy of 200 mills, the tax due the first year would be $60,000 [($1,000,000 x .30) x .200] or 60% of the gross production for that year. Of course, the exact figures here are incorrect to the extent that the fair market value of land is less than the total value of its severed contents. Nevertheless, the principal would remain the same. It should be noted also that the tax due here would be the same even if no minerals were produced.

Assuming the same facts as above, the value of the land in the tenth year would be $100,000 ($1,000,000 less $100,000 per year for nine years). The taxes in that year would be only $6,000 [($100,000 x .30) x .200] or only 6% of the mineral product for that year.

Under the state of facts assumed in note 137, the amount of taxes paid year by year would be

<table>
<thead>
<tr>
<th>Year</th>
<th>Land Value</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000,000</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>2</td>
<td>900,000</td>
<td>54,000</td>
</tr>
<tr>
<td>3</td>
<td>800,000</td>
<td>48,000</td>
</tr>
<tr>
<td>4</td>
<td>700,000</td>
<td>42,000</td>
</tr>
<tr>
<td>5</td>
<td>600,000</td>
<td>36,000</td>
</tr>
<tr>
<td>6</td>
<td>500,000</td>
<td>30,000</td>
</tr>
<tr>
<td>7</td>
<td>400,000</td>
<td>24,000</td>
</tr>
<tr>
<td>8</td>
<td>300,000</td>
<td>18,000</td>
</tr>
<tr>
<td>9</td>
<td>200,000</td>
<td>12,000</td>
</tr>
<tr>
<td>10</td>
<td>100,000</td>
<td>6,000</td>
</tr>
</tbody>
</table>

Total $330,000

If, however, the land owner doubled production, only $180,000 would be realized by the government, as shown by the following table.

<table>
<thead>
<tr>
<th>Year</th>
<th>Land Value</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000,000</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>2</td>
<td>800,000</td>
<td>48,000</td>
</tr>
<tr>
<td>3</td>
<td>600,000</td>
<td>36,000</td>
</tr>
<tr>
<td>4</td>
<td>400,000</td>
<td>24,000</td>
</tr>
<tr>
<td>5</td>
<td>200,000</td>
<td>12,000</td>
</tr>
</tbody>
</table>

$180,000

Finally, if the owner elected to leave the land idle he would have to pay a total of $600,000 ($60,000 x 10) for the ten year period.
tax revenues from this source, at least it is not assured of constantly decreasing revenues, as under an *ad valorem* tax scheme.

Finally, the administrative advantages of a proceeds tax should not be overlooked. Under the present law the net proceeds tax is substantially self-assessing. The duties of the State Board of Equalization and the county assessor are limited to the purely ministerial acts of computing the net proceeds, applying the millage levy, and sending out the tax statements. Duplication and wasted effort are minimized, since the State Board calculates the net proceeds for all mines in the state. Also, under the present scheme the value of the underlying "mine or mining claim" is irrelevant.

Under an *ad valorem* tax scheme, value of the mining property becomes all important because it is what is to be taxed. While it is not impossible to assess such property, its accurate valuation would require specialized training in engineering and economics far above the expertise of the average county assessor. And this valuation could change almost overnight due to changes in technology or the economy.

This is not to say that the present form of net proceeds tax is the best or fairest means of taxing mineral interests. It might be preferable to levy *ad valorem* taxes on all minerals as they are severed (in effect a "gross proceeds" tax) or to have the State Board of Equalization assess the proceeds of all mineral interests uniformly. These are offered only by way of example. Such conclusions would require an economic study of Montana's mining industry far beyond the scope of this article.

Whatever has been said about the wisdom of the basic purpose behind Section 3 does not apply to the means by which it has been carried into effect. To be blunt, the section is artlessly drafted. Such features as the conjunction of "mines" and "mining claims" when two different concepts were apparently intended, the enumeration of minerals and types of mining, and the general verbosity of the section have all contributed to a general confusion about the meaning of Section 3. That confusion has, in turn, generated much of the litigation which is the subject of this article.

But perhaps the most damning feature of Section 3 is that it is in the Constitution at all. The measure has a wise legislative purpose, its draftsmanship is passable; but even if it were perfect, that would be no reason to immortalize it in the stone of constitutional mandate.

The *Proceedings and Debates* are replete with examples of how the members of the Constitutional Convention viewed themselves as a sort of super-legislature whose goal was to embody in the Constitution as much of the then existing territorial legislation as possible. It was almost as if they did not realize that conditions by necessity change and

---

156 *Proceedings and Debates*, *supra* note 8.

Published by The Scholarly Forum @ Montana Law, 1971
even a foolish man on the spot stands a better chance of making a correct decision than even the wisest eighty years previously.

Under Section 3, as adopted, the legislature has been powerless to clarify its verbose and litigation-breeding language; powerless to adapt the purpose of that section to changing developments; and powerless to modify and correct an ill advised court decision.

"It is a wise man who can leave well enough alone." "Well enough" in this case would seem to be a simple provision granting the legislature the power to provide the means and form of taxing the proceeds of mineral interests.\(^{18}\)

HAROLD V. DYE