

U.S. District Court – IRC § 4611(b) imposes an unconstitutional tax on exports

Overview

In an opinion issued on September 8, 2020, the U.S. District Court for the Southern District of Texas held the Federal Oil Spill Tax imposed in Internal Revenue Code (IRC) § 4611(b) to be unconstitutional under the Export Clause of the United States Constitution.¹ While the U.S. District Court ruled that the tax was an unconstitutional tax on exports, the U.S. District Court did not address the issue of the proper remedy afforded to the taxpayer for having paid the unconstitutional tax in prior periods and requested additional factual development and briefing in connection with this issue.

This Tax Alert summarizes the factual background of the case, the U.S. District Court's decision, and provides taxpayer refund and compliance considerations.

Background

Congress established the Oil Spill Liability Trust Fund through the Omnibus Budget Reconciliation Act of 1986.² To provide the requisite funding, Congress imposed the Federal Oil Spill Tax pursuant at a rate of nine cents per barrel.³ The Federal Oil Spill Tax provides three incidences of taxation. First, under IRC § 4611(a), the tax is imposed on crude oil when the crude oil is received at a United States refinery.⁴ Second, under IRC § 4611(a), the tax is imposed on petroleum products entered into the United States for consumption, use, or warehousing.⁵ Third, under IRC § 4611(b), the tax is imposed if any domestic crude is used or exported from the United States and no tax was previously imposed on such domestic crude under IRC § 4611(a).⁶

The taxpayer — an “independent commodity trading and logistics house” — filed a refund of the IRC § 4611(b) tax to recover tax-paid on crude oil produced in Texas, Louisiana, and North Dakota and exported from the United States.⁷ The taxpayer asserted that the imposition of the IRC § 4611(b) tax on its crude oil exports violated the Export Clause of the Constitution, which states: “No Tax or Duty shall be laid on Articles exported from any State.”⁸ The Government argued that the IRC § 4611(b) tax should be considered a user fee, which is a classification that United States Supreme Court precedent has determined to be an exception to the Export Clause's prohibitions.⁹

¹ *Trafigura v. United States*, No. 4:19-CV-170 (S.D. Tex. Sep. 8, 2020).

² Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, 100 Stat. 1874; Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484; RAMSEUR, JONATHAN, L., CONG. RESEARCH SERV., R43128, OIL SANDS AND THE OIL SPILL LIABILITY TRUST FUND: THE DEFINITION OF “OIL” AND RELATED ISSUES FOR CONGRESS (Jan. 22, 2015) (noting that the Oil Spill Liability Trust Fund was created in 1986, however, Congress did not authorize its use or provide its funding until the passage of the Oil Pollution Act of 1990).

³ IRC §4611(c)(2)(B)(ii) (providing Federal Oil Spill Tax rate per barrel).

⁴ IRC §4611(a)(1).

⁵ IRC §4611(a)(2),

⁶ IRC §4611(b).

⁷ *Trafigura* at p. 1.

⁸ See, U.S. Const., Art. I, §9, Cl. 5.

⁹ *Trafigura* at p. 2.

Supreme Court Precedent – tax v. user fee

The primary issue before the U.S. District Court was “whether the taxes assessed on the oil exported by [taxpayer under IRC § 4611(b)] are unconstitutional taxes on exports or legitimate and constitutional user fees.”¹⁰ The U.S. District Court focused on two cases of Supreme Court precedent — *Pace v. Burgess*¹¹ and *United States v. U.S. Shoe Corp.*¹² — to craft the following two factors to determine whether a charge is a tax or a valid user fee:

- (1) Whether the charge is determined based on its proportion to the quantity or value of the package.
- (2) Whether the charge is excessive or whether it fairly matches the exporter’s use of the services provided by the funds from the charge.¹³

In *Pace*, the Supreme Court upheld a federal stamp tax on tobacco that exempted exporters from the tobacco tax but imposed a requirement that tobacco exporters purchase stamps to affix to the exported tobacco.¹⁴ The Supreme Court determined that the stamp tax was a legitimate user fee on exporters due to – (1) the tax being predetermined and not based upon the value of the tobacco or the quantity of the tobacco, and (2) the necessity of the stamp tax to prevent fraud related to exported tobacco.¹⁵

In *U.S. Shoe*, the Supreme Court applied its reasoning in *Pace* to rule that the federal Harbor Maintenance Tax violated the Export Clause. The Harbor Maintenance Tax in *U.S. Shoe* was distinct from the tobacco stamp tax in *Pace*. First, the Harbor Maintenance Tax was wholly an ad valorem tax based on the value of commercial cargo moving through the nation’s ports.¹⁶ Second, the Supreme Court noted that the services provided to the exporters under the tax were unrelated to tax itself, because the frequency and manner of the port’s use has no impact on the tax since it was an ad valorem tax.¹⁷

Constitutionality

The U.S. District Court applied the two factors referenced above to evaluate the constitutional permissibility of the IRC § 4611(b) Oil Spill Tax.¹⁸ As to the first factor, the court articulated that the IRC § 4611(b) Oil Spill Tax is “determined based on its proportion to the quantity of oil exported” and is charged at a fixed statutory per-barrel rate.¹⁹ As such, the court determined that under the first factor, IRC § 4611(b) Oil Spill Tax, on its face, is a tax and not a legitimate user fee.²⁰

The U.S. District Court further ruled that the application of the second factor to the IRC § 4611(b) Oil Spill Tax suggests that the tax is not a legitimate user fee. That is, the U.S. District Court found that for several reasons the IRC § 4611(b) Oil Spill Tax does not “fairly match the exporter’s use of the services provided by the funds raised from the charge.”²¹ The court reached this conclusion by emphasizing several points. First, the U.S. District Court noted that the benefit that the taxpayer receives from the charges are used for objectives unrelated to any potential benefit derived from the taxpayer securing potential oil spill “insurance” (e.g., the Oil Spill Trust Fund appropriates money for oil spill technology and environmental studies).²² Second, the U.S. District Court emphasized Congress’ deficiency in tailoring the IRC § 4611(b) Oil Spill Tax to “fairly match the exporters’ use of the government service.” For example, the Court referenced the taxpayer’s export of crude oil by truck from the United States would receive no benefit as the limitation from liability under the charge only applies to oil spills on water.²³

¹⁰ *Trafigura* at p. 1.

¹¹ *Pace v. Burgess*, 92 U.S. 372 (1875).

¹² *United States v. U.S. Shoe Corp.*, 523 U.S. 360 (1998).

¹³ *Trafigura* at p. 5.

¹⁴ *Pace*, 92 U.S. at 374.

¹⁵ *See, Trafigura* at p. 5 (citing, *Pace*, 92 U.S. at 376).

¹⁶ *U.S. Shoe*, 523 U.S. at 369.

¹⁷ *U.S. Shoe*, 523 U.S. at 370.

¹⁸ *Trafigura* at p. 6-11.

¹⁹ *Trafigura* at p. 6-7.

²⁰ *Id.*

²¹ *Trafigura* at p. 7-11.

²² *Id.*

²³ *Trafigura* at p. 9-10.

Remedy for paying the tax imposed by IRC § 4611(b)

While the U.S. District Court ruled that the tax imposed by IRC § 4611(b) is an unconstitutional tax on exports, the Court did not address the issue of the remedy afforded to the taxpayer for having paid the unconstitutional tax in prior periods. As summarized by the U.S. District Court, possible remedies may include a full refund of taxes paid plus statutory interest or no refund of taxes paid unless taxpayer is able to “show that it actually bore the economic burden of the taxes, i.e. that it did not pass the taxes on to its customers.”²⁴ The U.S. District Court has requested additional factual development and briefing on this issue.

Considerations

The U.S. District Court’s opinion does not impact the Oil Spill Tax imposed under IRC § 4611(a). Further, the U.S. District Court has yet not ruled on whether a taxpayer seeking a refund of § 4611(b) taxes previously paid will need to demonstrate that it ultimately bore the economic liability of the tax by not effectively passing the burden of the tax to its customers. Finally, to the extent that the taxes imposed under § 4611(b) were deducted in the computation of taxable income in prior periods, companies should consider whether any refunds granted may need to be included in taxable income to avoid any double benefit.

In the meantime, companies that pay the Oil Spill Tax under IRC § 4611(b) should consider whether to file protective refund claims pending a decision by the Court on the remedy issue and/or a potential appeal of the constitutional issue.

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²⁴ *Id.* at 11.
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