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Multistate Tax
EXTERNAL ALERT

U.S. Supreme Court Remands Alabama Sales Tax "4-R Act" Case to 11th Circuit

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Overview

In *Alabama Department of Revenue v. CSX Transportation, Inc.*, the U.S. Supreme Court ("Court") recently reversed in part and remanded an earlier U.S. Court of Appeals, Eleventh Circuit ("11th Circuit") decision.[1] The 11th Circuit had held Alabama's sales tax regime, which imposes a sales tax on a railroad's purchases of diesel fuel but exempts similar purchases by certain competitors, violated the anti-discrimination provisions of the Railroad Revitalization and Regulatory Reform Act ("4-R Act"). In accordance with 49 U.S.C. § 11501(b)(4) ("subsection (b)(4)") of the 4-R Act, a state is prohibited from "impos[ing] another tax that discriminates against a rail carrier providing transportation . . . ."[2]

In its Opinion, delivered by Justice Scalia, the Court agreed with the 11th Circuit's holding that the appropriate comparison class of "similarly situated" taxpayers for purposes of determining discrimination was the taxpayer's competitors (*i.e.*, motor and water carriers).[3] The Court, however, disapproved of what it viewed as the 11th Circuit's refusal or failure to examine whether Alabama could justify its disparate treatment of the taxpayer and its common carrier competitors.[4] The Court concluded that for a 4-R Act subsection (b)(4) violation to occur, the applicable tax "must discriminate—but it does not discriminate unless it treats railroads differently from other *similarly situated* taxpayers w*ithout sufficient justification*."[5] Accordingly, the Court remanded the case to the 11th Circuit for further proceedings to address whether Alabama can demonstrate the requisite "sufficient justification."[6]

In this Tax Alert, we review the 11th Circuit's decision, summarize the Court's decision and provide some taxpayer considerations.

Background

The taxpayer in *CSX* provides railroad transportation services in multiple states, including Alabama. As stipulated by the parties, the taxpayer's competitors for the shipment of freight in interstate commerce are motor and water carriers. Rail, motor and water carriers purchase diesel fuel in order to provide transportation services. Under Alabama's sales tax regime, the purchase of diesel fuel is generally subject to the 4% sales tax. Alabama provides a sales tax exemption for diesel fuel purchased by a water carrier "engaged in foreign or international commerce or interstate commerce"[7] and for diesel fuel purchased by motor carriers who are instead subject to a 19 cent per gallon fuel-excise tax.[8] However, the state does not exempt from sales tax diesel fuel purchased by a rail carrier.

11th Circuit Court Decision[9]

On July 1, 2013, the 11th Circuit reversed and remanded a U.S. District Court, Northern District of Alabama ("District Court") decision that 4-R Act subsection (b)(4) discrimination had not occurred.[10] In addressing the appropriate comparison class of "similarly situated" taxpayers, the 11th Circuit acknowledged that the other Circuits were split on this issue and generally applied either: the functional approach (including all other commercial and industrial taxpayers in the

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[1] *Ala. Dep't of Revenue v. CSX Transp., Inc.*, No. 13-553, slip op, at 10 (U.S. Mar. 4, 2015), *rev'g and remanding* 720 F.3d 863 (11th Cir. 2013). The Court's decision is available **here**.

[2] 49 U.S.C. § 11501(b)(4). Note that the subsection (b)(4) reference to "another tax" distinguishes that provision from subsections (b)(1)-(3), which "contain three specific prohibitions directed towards property taxes." No. 13-553 at 4.

[3] No. 13-553 at 7-8.

[4] *Id.* at 8-9. As explained by the Court, "We . . . cannot approve of the Eleventh Circuit's refusal to consider Alabama's tax-based justification. . . . The Eleventh Circuit failed to examine these [other] justifications . . . ." *Id.* at 9.

[5] *Id.*

[6] *Id.* at 8.

[7] Ala. Code § 40-23-4(a)(10).

[8] Ala. Code § 40-17-325(b).

[9] For additional information on the procedural history that preceded the 11th Circuit proceedings, please see our **January 16, 2015, Alert**.

[10] *CSX Transp., Inc. v. Ala. Dep't of Revenue*, 720 F.3d 863 (11th Cir. 2013).

comparison class) or the competitive approach (limiting the comparison class to interstate motor and water carriers).[11] The 11th Circuit concluded that the appropriate approach was the competitive approach.[12] The 11th Circuit then declined to evaluate the overall fairness of Alabama's tax structure in relation to purchases of diesel fuel, stating "we look only at the sales and use tax with respect to the fuel to see if discrimination has occurred."[13] Thus, it was not relevant that Alabama's tax structure required motor carriers to pay a fuel-excise tax on their diesel fuel purchases.[14]

Supreme Court Decision[15]

The Court reversed in part the 11th Circuit's decision and remanded the case for further proceedings.[16] In explaining the basis of its analysis, the Court summarized discrimination under 4-R Act subsection (b)(4) as follows: "a tax discriminates under subsection (b)(4) when it treats 'groups [that] are similarly situated' differently without sufficient 'justification for the difference in treatment.'"[17] Focusing on these concepts, the Court addressed the following two issues: (1) the proper class of "similarly situated" taxpayers to which the court should compare a railroad when gauging discrimination ("comparison class"); and (2) the extent that the court should consider other aspects of a state's tax scheme in order to determine whether a state is "sufficiently justified" to treat "similarly situated" taxpayers differently ("discrimination").

Comparison Class

The Court concluded that the general statutory language of subsection (b)(4) does not define the comparison class, and the comparison class should not be limited to other commercial and industrial taxpayers as provided in 49 U.S.C. § 11501(b)(1)-(3).[18] The Court explained that the comparison class will depend on the theory of the discrimination alleged.[19] If the railroad asserts that the tax burdens railroads more significantly than local businesses, all other commercial and industrial taxpayers are the comparison class.[20] If the railroad alleges that a tax disadvantages it as compared to its competitors in the transportation industry, the railroad's competitors in that jurisdiction are the comparison class.[21] Applying this reasoning to the case before it, the Court determined that the 11th Circuit had "properly concluded that, in light of the taxpayer's complaint and the parties' stipulation, a comparison class of competitors consisting of motor carriers and water carriers was appropriate. . . ."[22]

Discrimination

The Court reasoned that for a subsection (b)(4) violation to occur, a state's tax is deemed to discriminate "only where the State cannot sufficiently justify differences in treatment between similarly situated taxpayers."[23] Applying this reasoning, the Court first examined Alabama's exemption for motor carriers, whose fuel purchases are exempt from the sales tax but are instead subject to a fuel-excise tax that was cited by the Court as "Alabama's tax-based justification."[24] Noting that "[t]here is simply no discrimination when there are roughly comparable taxes[,]" the Court stated that it disapproved of the 11th Circuit's "refusal to consider Alabama's tax-based justification" for the disparity between railroads and motor carriers.[25] On this basis, the Court remanded the case for the 11th Circuit to "consider whether Alabama's fuel-excise tax is the rough equivalent of Alabama's sales tax as applied to diesel fuel. . . ."[26]

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[11] *Id.* at 867-868.
[12] *Id.* at 869.
[13] *Id.* at 869, citing *Union Pac. R.R. Co. v. Minn. Dep't of Revenue*, 507 F.3d 693, 695 (11th Cir. 2007).
[14] The 11th Circuit's decision rejected the approach employed by the District Court in its analysis of a rail carriers' competitors in "all relevant respects," including an evaluation of the state's overall tax scheme. *See*, *CSX Transp., Inc. v. Ala. Dep't of Revenue*, 892 F.Supp.2d 1300, 1312 (N.D. Ala. 2012).
[15] For additional information on the oral arguments presented before the Court on Dec. 9, 2014, please see our **January 16, 2015, Alert**.
[16] *Ala. Dep't of Revenue v. CSX Transp., Inc.*, No. 13-553, at 10 (U.S. Mar. 4, 2015).
[17] *Id.* at 3-4, *citing CSX Transp., Inc. v. Ala. Dep't of Revenue*, 562 U.S. 277, 287 (2011).
[18] The dissent, in contrast, explained that the statutory structure "supports the conclusion that a tax 'discriminates against a rail carrier' within the meaning of subsection (b)(4) if it singles out the railroads for unfavorable treatment as compared to the general class of commercial and industrial taxpayers." *Id.* at 2 (Thomas, J., dissenting). Under 49 U.S.C. § 11501(b)(1)-(3), which addresses prohibited practices in the property tax context, the statutory language provides a comparison class of "other commercial and industrial" taxpayers.
[19] No. 13-553 at 5.
[20] *Id.*
[21] *Id.*
[22] *Id.* at 7-8. As noted previously, the parties had stipulated that the taxpayer's competitors involving the shipment of freight in interstate commerce are motor and water carriers.
[23] *Id.* at 8. As stated by the Court, for a subsection (b)(4) violation to occur, the tax "must discriminate—but it does not discriminate unless it treats railroads differently from other *similarly situated* taxpayers w*ithout sufficient justification*." *Id.*
[24] *Id.* at 9.
[25] *Id.*
[26] *Id.*

The Court next recognized that Alabama did not have a similar justification in the context of water carriers, as water carriers pay neither the sales tax nor the fuel-excise tax with respect to their fuel purchases.[27] However, Alabama had offered alternative justifications, such as that the exemption applicable to water carriers is compelled by federal law. Although the Court did not consider this or other justifications asserted by Alabama, the Court held that the 11th Circuit erred in its failure to do so.[28] Accordingly, the Court remanded the case with instruction that the 11th Circuit "consider whether Alabama's alternative rationales justify its exemption."[29]

Considerations

Railroad taxpayers should continue to monitor the status of *CSX*, as the 11th Circuit decides whether Alabama has "sufficient justification" to support tax disparity between the taxpayer and its competitors under a 4-R Act subsection (b)(4) discrimination claim. Railroad taxpayers should also consider whether potential relief may be sought in jurisdictions that had previously applied the functional approach (including all other commercial and industrial taxpayers in the comparison class) to subsection (b)(4) discrimination claims, as it appears the Court has settled the Circuit split on the comparison class in favor of an approach that depends on the theory of the alleged claim.

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[27] *Id.*
[28] *Id.* at 9-10.
[29] *Id.* at 10.