In a tax case that has had more twists and switchbacks than the Swiss Glacier Express, rail carrier CSX scored an important victory on March 23, 2018, in its decade-long effort to challenge what they contended was an unlawfully discriminatory 4 percent ad valorem sales and use tax imposed on rail carriers by the state of Alabama for purchases or use of diesel fuel inside the state. The tax challenge twice went to the U.S. Supreme Court before the most recent remand to the U.S. Court of Appeals for the Eleventh Circuit, which ruled that the fuel tax unlawfully discriminated against railroads operating in Alabama in violation of the Railroad Revitalization and Regulatory Reform Act, 49 U.S.C. 11501(b)(4) (the 4-R Act). In a two-part decision, the court ruled first that the railroad tax was not discriminatory in comparison to the motor carrier industry, because the state of Alabama achieved a “rough justice” by requiring motor carriers to pay similar taxes. However, the court also ruled that the rail tax was unlawfully discriminatory vis-à-vis water carriers, because they were not subject to any Alabama tax whatsoever on the purchase or use of fuel within the state.

The decision is important for the transportation industry because it demonstrates that persistence can pay off and that state taxing regimes for fuel and other purchases are subject to challenge if the state fails to ensure that it is treating different modes of transportation in a fair and non-discriminatory manner. States view transportation modes as offering an “easy mark” for taxes, regardless of whether the carriers or the traveling public directly benefit from the exaction. The Alabama sales and use tax on fuel imposed on rail carriers is a prime example: the 4 percent tax was directed to the state general fund and earmarked for education purposes – a worthy beneficiary but with zero connection to railways or their maintenance or improvement.
Railroad Success (For Now) in Challenging State Fuel Tax as Unlawfully Discriminatory

Under these circumstances, CSX insisted that it was unfair and violated the 4 R Act to subject rail carriers to the 4 percent tax which was not in turn also imposed on motor carriers and water carriers that also bought or used fuel within Alabama. CSX initially sued the Alabama Department of Revenue in 2008, seeking to enjoin the department from collecting the sales and use tax on the railroad’s purchase or consumption of diesel fuel in the state, and asked for a declaratory judgment that the tax violated the 4-R Act. Congress enacted the 4-R Act to “restore the financial stability of the railway system of the United States” and to “foster competition among all carriers by railroad and other modes of transportation.” 45 U.S.C. 801(a), (b) (2). The 4-R Act forbids states from discriminating against rail carriers in assessing property or imposing taxes.

Fast forward through years of litigation — in the district court, the Eleventh Circuit and two trips to the U.S. Supreme Court — the appeals court reached a decision that the railroad tax is not discriminatory when compared to the excise tax paid by motor carriers because the railroad tax is “roughly equivalent” to the excise tax paid by motor carriers. This is because over a nine-year period the average rates rail and motor carriers paid on diesel fuel differed “by some quantity between less-than-half-of-one cent and 3.5 cents,” per gallon. In layman’s terms, this was “good enough for government work.” The law against discrimination does not require exactitude: rough justice is sufficient.

But CSX fared much better with its claim that water carriers were treated better. The math was unassailable: Railroads pay 4 percent taxes and water carriers pay 0 percent tax. The state’s only defense was to insist that if water carriers are forced to pay state taxes for fuel, those taxes will violate federal law. However, the Eleventh Circuit was unimpressed with these arguments, considered to be both speculative and irrelevant. And from CSX’s perspective, the fact that a tax on water carriers might violate federal law did not justify treating CSX in a discriminatory manner. In the words of the Eleventh Circuit: “Having concluded that the water carrier exemption is not ‘compelled by federal law; and that neither of the state’s ‘alternative rationales’ justifies the water carrier exemption, . . . we hold that Alabama’s sales and use tax violates the 4-R Act.” The court directed the district judge “to enter declaratory and injunctive relief in favor of CSX consistent with this opinion.”

Once again, the new CSX decision reaffirms that transportation carriers are well advised to use a critical eye when scrutinizing state and local tax authorities, to ensure that the tax burden is fair and not being imposed in an unlawfully discriminatory manner.

It is certainly possible that this dispute will go before the U.S. Supreme Court a third time – only time will tell. But Friday was a good day for transportation industry challenges to onerous taxes.
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For more information on this CSX decision, please contact Jim Bertrand, Doug Dalglish, Tracey Holmes Donesky, Roy Goldberg, David Rifkind or the Stinson Leonard Street contact with whom you regularly work.

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