

# Alabama - Sales tax on rail carrier's diesel fuel purchases discriminatory in violation of federal act

July 11, 2013

## In brief

In a 2-1 decision, the Eleventh Circuit US Court of Appeals found that Alabama's sales tax violated a federal act precluding tax discrimination against rail carriers because their purchases of diesel fuel were subject to the tax while similar purchases by competitors such as motor and water carriers were exempt. While this decision is specific to rail carriers, it remains instructive for challenges of current or potential future federal laws that prohibit discriminatory state taxation. [[\*CSX Transportation, Inc. v. Alabama Department of Revenue\*](#), No. 2:08-cv-00655-AKK, 11<sup>th</sup> Cir. (7/1/13)]

## In detail

### Background

As an interstate rail carrier, CSX Transportation, Inc. pays Alabama's 4% sales tax on diesel fuel purchases in the state. Alabama imposes an excise tax equal to \$0.19 per gallon of diesel fuel purchased by motor carriers and exempts from tax diesel fuel purchased by water carriers.

The federal Railroad Revitalization and Regulatory Reform Act of 1976 (Act) provides generally that a state may not impose a tax that "discriminates against a rail carrier providing transportation."

CSX argued that Alabama's sales tax violated the Act's ban on discrimination because

CSX's main competitors do not pay the sales tax when they purchase diesel fuel, giving them a competitive advantage over CSX.

Early in the litigation the US Supreme settled a procedural issue, ruling that CSX was able to challenge Alabama's sales tax to the extent it discriminates against rail carriers under the Act. [Click here](#) for our summary of the US Supreme Court's decision.

### Alabama tax discriminates in violation of the Act

The Eleventh Circuit US Court of Appeals found that (1) the Alabama sales tax was discriminatory in violation of the Act; and (2) the state did not offer a 'sufficient justification'

for exempting CSX's competitors.

In reaching its conclusion that the tax is discriminatory, the court resolved the question regarding the class of taxpayers that should be compared against rail carriers. If compared to all state taxpayers, rail carriers are no worse off because most taxpayers pay the sales tax on diesel fuel. The court found that rail carrier taxation should be compared against taxation of motor and water carriers, which results in rail carriers operating at a discriminatory disadvantage.

The court held that, because the sales tax overburdens rail carriers by exempting their competitors, CSX established a

prima facie case of discrimination. The court rejected the state's argument that motor carriers may have an equivalent *overall* diesel fuel tax burden as a result of the \$0.19 per gallon excise tax. Rather, the court looked only to the sales and use tax to determine if discrimination occurred with respect to fuel purchases.

With discrimination established, the burden shifted to the state to justify its discriminatory tax. However, the state failed to offer any reasonable distinction between the favored (water and motor carriers) and the disfavored (rail carriers).

Accordingly, the court held in favor of CSX, finding that Alabama's sales tax on diesel fuel purchased by rail carriers violated the Act.

### ***The takeaway***

While this decision is specific to rail carriers, it remains instructive for challenges of current (e.g. the Internet Tax Freedom Act) or potential future (e.g., Digital Goods Fairness Act, Wireless Fairness Act, etc.) federal laws that prohibit discriminatory taxation.

The CSX decision may also be instructive as it details the different

methodologies a court may utilize to determine the class against which a taxpayer is compared for purposes of establishing discrimination. Some federal appellate courts addressing this issue under the Act adopted a 'functional approach,' which expands the comparison class to all commercial and industrial taxpayers and makes a discrimination challenge more difficult for taxpayers. The court in this case, however, adopted a 'competitive approach,' which allowed rail carriers to be compared with direct industry competitors such as motor and water carriers.

### ***Let's talk***

For more information about the CSX decision, please contact:

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