113TH CONGRESS
2D SESSION

H. R. 3086

AN ACT

To permanently extend the Internet Tax Freedom Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Permanent Internet Tax Freedom Act''.

SEC. 2. PERMANENT MORATORIUM ON INTERNET ACCESS TAXES AND MULTIPLE AND DISCRIMINATORY TAXES ON ELECTRONIC COMMERCE.

(a) IN GENERAL.—Section 1101(a) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking '' during the period beginning November 1, 2003, and ending November 1, 2014''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxes imposed after the date of the enactment of this Act.

Passed the House of Representatives July 15, 2014.

Attest:

Clerk.

113TH CONGRESS
2D SESSION

H. R. 3086

AN ACT

To permanently extend the Internet Tax Freedom Act.

NIHC, Inc. v. Comptroller of the Treasury
No. 63, September Term 2013

Taxation - Income Tax - Corporations - Tax Assessment of Subsidiary without Economic Substance Separate from Parent Corporation on Income Shifted from Parent to Subsidiary. In *Comptroller v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399 (2003), the Court of Appeals held that a corporate subsidiary that lacked economic substance as a business entity separate from its parent corporation had a sufficient nexus with Maryland such that its income was taxable in Maryland to the same extent as the parent corporation's income. In the instant case, a parent corporation created several subsidiaries, which then engaged in a series of transactions among themselves and with the parent corporation concerning licensing rights to the parent corporation's trademarks, the net effect of which was to shift part of the parent's income to the subsidiaries. The Comptroller assessed the subsidiaries for Maryland income tax on the shifted income. Applying *SYL*, the Maryland Tax Court found that the subsidiaries lacked economic substance separate from their parent corporation, that they had a nexus with Maryland through the parent's business activities, and that their income was taxable in Maryland to the same extent as the parent corporation's income. One of the subsidiaries contested the assessment on the ground that it had mistakenly reported income on its 2002 and 2003 Maryland tax returns – although it had apportioned none of that income to Maryland – and, under a Maryland statute requiring the filing of separate corporate returns, should have reported the income on its 1999 return, which was now outside the period of limitations. The Tax Court rejected that argument. In the circumstances of this case, where the Tax Court found that the income reported on the 2002 and 2003 returns of the subsidiary related to activities of the parent corporation in Maryland during those tax years and that the subsidiary lacked economic substance apart from its parent, and where the subsidiary had not filed amended returns to reflect its new view of how it should have reported that income, the Maryland requirement of separate corporate tax returns did not prohibit the Comptroller from assessing a tax on the income reported on the subsidiary's 2002 and 2003 Maryland tax returns.

Circuit Court for Baltimore County
Case No. 03-C-10-9151
Argued: March 7, 2014

IN THE COURT OF APPEALS
OF MARYLAND

No. 63

September Term, 2013

NIHC, INC.

v.

COMPTROLLER OF THE TREASURY

Barbera, C.J.
Harrell
Battaglia
Greene
Adkins
McDonald
Watts,

JJ.

Opinion by McDonald, J.

Filed: August 18, 2014

Once upon a time, before the advent of the shot clock, some basketball teams employed a maneuver known as the "four corners offense." This strategy involved a series of passes among team members that seemingly did not advance the ultimate purpose of putting the ball in the hoop, but had the separate purpose of depriving the opposing team of possession of the ball. In a somewhat analogous enterprise, corporate tax consultants devised a strategy that involved a series of transactions passing licensing rights between related corporations and that was motivated by a desire, not to directly enhance corporate profits, but to keep a portion of those profits out of the hands of state tax collectors. Much as the shot clock led to the demise of the four corners offense, judicial decisions during the past two decades have limited the utility of this tax avoidance strategy.[1]

This case illustrates a variation on that theme. Nordstrom, Inc. ("Nordstrom") created several subsidiary corporations, including Petitioner NIHC, Inc. ("NIHC"), which then engaged in a series of transactions with Nordstrom and with each other, involving the licensing rights to Nordstrom's trademarks. When the dust settled, the rights to use Nordstrom's trademarks ended up where they had begun – with Nordstrom. But Nordstrom's Maryland taxable income was significantly reduced. NIHC, although it had engaged in no value-creating business activity itself, recognized a significant gain – putatively beyond the reach of Maryland taxation – that was ultimately related to the reduction in Nordstrom's Maryland taxable income. From the perspective of the Respondent Comptroller, the

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[1] *See, e.g., Comptroller v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399, *cert. denied*, 540 U.S. 984 *and* 540 U.S. 1090 (2003); *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C.), *cert. denied,* 510 U.S. 992 (1993).

transactions appeared to be an effort to shift income from Nordstrom – where a portion of it would be taxable by Maryland – to subsidiaries that arguably had no nexus to Maryland – where the income would escape Maryland taxation. The Comptroller did not accept that conclusion and issued tax assessments against the subsidiaries' income. The Tax Court concluded, and the Circuit Court and the Court of Special Appeals affirmed, that the subsidiaries, including NIHC, lacked economic substance separate from Nordstrom and, applying a recent decision of this Court, that their income had a nexus with Maryland through Nordstrom's business activities and was therefore taxable by Maryland.

There is an additional feature that makes this case distinctive: NIHC (actually, Nordstrom, on behalf of NIHC) contends that it misunderstood the differences in the ways in which corporations must file returns federally and in Maryland and that it made a mistake in reporting income on its Maryland returns for 2002 and 2003 – a mistake which, it argues, should absolve it from paying the assessed tax. In particular, federal law provides for the filing of a consolidated return by related corporations while Maryland law requires the filing of separate returns by related corporations. NIHC asserts that, under Maryland's separate reporting requirement, it should have reported – and thus paid Maryland income tax – on the entire gain it recognized as a result of the transactions with Nordstrom and the other subsidiaries in 1999, a tax year now outside the statute of limitations, and that it instead mistakenly reported a portion of that income on its Maryland returns for the tax years in question – tax years 2002 and 2003. The Tax Court held that the separate reporting

requirement in Maryland did not prohibit Maryland taxation of the income actually reported on the 2002 and 2003 NIHC returns. The Circuit Court held otherwise, but the Court of Special Appeals reversed.

We agree with the Court of Special Appeals that the decision of the Tax Court should be upheld on judicial review. There appears to be no question that income recognized by NIHC from these transactions has a connection to business activities of Nordstrom in Maryland during 2002 and 2003, that a portion of that income was reported on NIHC's Maryland returns for 2002 and 2003 (which were never amended to reflect its current theory), and that the income is taxable by Maryland. The fact that NIHC may have made a series of mistakes in the preparation of its Maryland tax returns, as a result of transactions apparently devised to avoid state taxation, does not entitle it to escape its tax liability on that income.

Background

Corporate Family Portrait

The underlying facts are not in dispute. Nordstrom is a nationally known retailer with its principal place of business in Seattle, Washington. During the time period relevant to this

case, it operated stores in 27 states, including Maryland.[2] During that time, Nordstrom filed consolidated federal income tax returns with its domestic subsidiary corporations.[3]

In the mid-1990s, Nordstrom decided to transfer its trademarks to a subsidiary for tax purposes, according to a plan labeled the "anti-*Geoffrey* strategy" by its tax consultant.[4] To

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[2]During that time, Nordstrom operated four department stores, two discount stores, and one distribution center in Maryland.

[3]The Internal Revenue Code permits an affiliated group of corporations, consisting of a parent corporation and more than 80 percent-owned domestic subsidiaries, to file consolidated returns. 26 U.S.C. §1504(a).

[4]A representative of Nordstrom testified at the Tax Court hearing in this case that the transfer was motivated by the company's desire to avoid a personal property tax on intangibles in Washington state that might be extended to its trademarks. Documents admitted in evidence in the Tax Court indicated that the corporate structure and transactions were also part of a strategy devised by Nordstrom's tax consultant, Deloitte & Touche LLP, to circumvent state court rulings that permitted states to tax the income of foreign subsidiaries created with the purpose of holding intangible assets and shifting income beyond reach of the tax collector. Deloitte & Touche referred to the plan as an "anti-*Geoffrey* strategy" – a reference to a South Carolina Supreme Court decision that held that South Carolina could tax royalties received by an out-of-state subsidiary holding the trademarks of its parent. *Geoffrey Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C.), *cert. denied*, 510 U.S. 992 (1993). In *Geoffrey*, the retailer Toys R Us created a second-tier subsidiary (Geoffrey, Inc.), to which it transferred trademarks and trade names; the subsidiary then licensed them back in return for royalties paid by the parent, which had the net effect of shifting income from the parent to a subsidiary that arguably did no business in South Carolina. The South Carolina Supreme Court held that the royalty income of Geoffrey, Inc. had a nexus with South Carolina through the use of the trademarks in that state by Toys R Us, and was subject to taxation in South Carolina without offending the Commerce Clause or Due Process Clause of the federal constitution.

While the Nordstrom representative acknowledged that the company had carried out the anti-*Geoffrey* strategy proposed by Deloitte & Touche, she insisted that the holding company structure was motivated primarily by a desire to avoid the Washington state personal property tax. In any event, there appears to be no dispute that the creation of the

(continued...)

carry out that plan, in late 1996, Nordstrom created subsidiary corporations called NTN, Inc. ("NTN") and NIHC, Inc. ("NIHC") in Colorado; a few months later, in March 1997, it created a third subsidiary in Colorado called N2HC, Inc. ("N2HC"). Nordstrom owned the stock of all three subsidiaries.

During the relevant time period, all of the officers of NIHC and N2HC were officers or employees of Nordstrom. Both corporations occupied rented office space in Portland, Oregon, staffed by a paralegal employed by N2HC. The operating expenses of the affiliates were relatively minimal. NIHC and N2HC had little income or expense other than that related to the trademark transactions described below.

Passing the Trademark Rights around the Corporate Family

Nordstrom transferred its trademarks to NTN in March 1997, and NTN in turn gave Nordstrom a license to continue to use the trademarks. In April 1997, Nordstrom transferred its stock in NTN and NIHC to N2HC for cash. Thus, relevant to the discussion below, N2HC became the sole shareholder of NIHC.

On January 31, 1999, the license agreement between NTN and Nordstrom was terminated. NTN then entered into a license agreement with NIHC that granted NIHC a non-exclusive license to use and sublicense the Nordstrom trademarks.[5] On the same day, NIHC

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[4](...continued)
subsidiaries and the ensuing inter-company transactions originated as an effort to avoid state taxes, as opposed to an effort to enhance the retailer's revenue or profits.

[5]NTN eventually assigned the trademarks to NIHC in January 2001.

distributed to N2HC, its parent corporation, the license agreement with NTN. Thus, as of the end of January 1999, N2HC had the right to license Nordstrom's trademarks and the right to any income generated through the exercise of that right.

The next day – February 1, 1999 – N2HC entered into a license agreement with Nordstrom under which N2HC granted Nordstrom a license to use the trademarks for an arms-length royalty.[6] Nordstrom paid N2HC royalties during the relevant time period. For the tax years 2002, and 2003, Nordstrom paid N2HC royalties in the amount of $197,802,386, and $212,284,273, respectively.[7] N2HC in turn made loans back to Nordstrom in slightly lesser amounts during the same period.[8]

At the conclusion of these transactions, Nordstrom continued to have the right to use the trademarks; the trademarks were the property of NIHC; and N2HC had the right to license the trademarks and receive royalties from Nordstrom. During the relevant period, trademarks were licensed only to Nordstrom, NIHC conducted no business other than owning

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[6]NIHC passed the right to license Nordstrom trademarks from NTN to N2HC on the same day that it received the licensing right from NTN. NIHC did not directly license the trademarks to Nordstrom or directly receive a royalty from Nordstrom.

[7]Deloitte & Touche appraised the value of the trademarks and determined an appropriate royalty rate to be paid by Nordstrom. As of October 31, 1998, the value of the trademarks was determined to be approximately $2.8 billion. Deloitte & Touche did not determine the value of the licensing agreements.

[8] N2HC made loans back to Nordstrom of approximately two-thirds of the royalties in each of those years, which Nordstrom used for operating capital. Nordstrom paid N2HC interest, but paid back only small percentages of the principal of the loans. According to testimony at the Tax Court hearing, N2HC did not make loans to other entities.

the trademarks, and both NIHC and N2HC had no earnings other than those resulting from the transactions among the affiliates described above. The net effect was to shift income from Nordstrom to the subsidiaries which, considered in isolation from their parent, had no connection to Maryland.[9]

Accounting of the Trademark Transactions for Federal Tax Purposes

According to the analysis of Nordstrom's tax consultant, under the federal tax code, the distribution of the license agreement from NIHC to N2HC was considered the distribution of appreciated property that would be recognized as a gain to NIHC under §311(b) of the Internal Revenue Code, 26 U.S.C. §311(b).[10] According to that analysis,

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[9]The Comptroller's final determination letter later summarized the effect of these transactions:

> ... These transactions ensured that licensing expenses were incurred by Nordstrom and made payable to N2HC, an entity operating outside of Maryland. By setting up NIHC, Nordstrom indirectly created licensing expenses attributable to inter-company intangible property transfers, where previously, none would have existed. By doing so, a significant portion of Nordstrom's income was moved out of Maryland.

[10]That statute states an exception to the general rule set forth in 26 U.S.C. §311(a) that a corporation is not to recognize a gain or loss when it distributes stock or property to shareholders. It provides in pertinent part:

> (b) Distributions of Appreciated Property. –
>
> (1) In General. – If –
>
> (A) a corporation distributes property ... to a shareholder in a distribution to which subpart A applies, and

(continued...)

NIHC was required under federal tax law to recognize a gain to the extent that the market value of the licensing agreement exceeded the book value of the dividend.[11] In addition, the dividend created a basis in N2HC that was subject to amortization under federal tax law.[12] Accordingly, Nordstrom was required to report the value of the distribution as a gain by NIHC, as well as the amortization of N2HC's basis, on Nordstrom's consolidated federal tax return for the fiscal year that ended on January 31, 1999.

As indicated above, Nordstrom filed a consolidated federal return with its subsidiaries, including NIHC and N2HC. Under federal regulations relating to consolidated returns, the gain from the license distributed by NIHC to N2HC was to be deferred over 15 years,[13]

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[10](...continued)

> (B) the fair market value of such property exceeds its adjusted basis (in the hands of the distributing corporation),
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> then gain shall be recognized to the distributing corporation as if such property were sold to the distributee at its fair market value. ....

[11]In footnotes to its brief, the Comptroller contends that Nordstrom and NIHC made "improper use" of §311(b) and suggests that recognition of the gain at that time was not mandatory under federal law. We need not resolve these questions of federal tax law to decide this case.

[12]*See* 26 U.S.C. §197.

[13]*See* 26 CFR §1-1502-13. The 15-year period corresponded to N2HC's amortization of the value of the right to license the trademarks under 26 U.S.C. §197. This reporting of income and amortization deduction in the consolidated return for the transaction between two affiliates resulted in no income from the transaction for federal purposes.

because the transaction was between affiliated corporations.[14] For example, for tax years 2002 and 2003, Nordstrom's consolidated federal returns reported income to NIHC in the amount of $186,133,333, and a deduction for amortization expense for N2HC in an identical amount.

NIHC's Maryland Tax Returns

Under Maryland law, a corporation is subject to tax on income derived from or reasonably attributable to its business activities in Maryland. Maryland Code, Tax-General Article ("TG"), §10-402. Any corporation with Maryland taxable income during a tax year must file an income tax return for that year. TG §10-810. Each member of an affiliated group of corporations is to file a separate income tax return. TG §10-811.

During the relevant years, NIHC and N2HC filed separate income tax returns in Maryland that showed no income apportioned to Maryland from the transactions involving the Nordstrom trademarks. In its Maryland returns for 2002 and 2003, NIHC reported the deferred gain shown on the consolidated federal returns. In particular, NIHC reported Maryland modified income of $186,240,824 and $186,128,851 for 2002 and 2003 respectively, but, as indicated above, did not apportion any of that income to Maryland.[15]

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[14] Under the tax consultant's "anti-*Geoffrey* strategy," see footnote 4 above, the use of an additional entity (NIHC) was intended to convert the stream of royalty income into a one-time transfer of appreciated property that made its income-shifting purpose less obvious than the strategies used in *Geoffrey* and *SYL*, which involved royalty payments from a parent to a subsidiary holding company.

[15] N2HC's Maryland returns reported Maryland modified income of $18,375,611 and (continued...)

Although NIHC subsequently took the position before the Tax Court that it had concluded in 2005 that its 2002 and 2003 Maryland returns should not have reported the deferred gain at all, it did not file amended returns for those years.

Assessment by the Comptroller following Audit of the Maryland Returns

In September 2006, the Comptroller issued Notices of Assessment against Nordstrom, NIHC, and N2HC, based on the position that income-shifting in the form of trademark royalty expenses had resulted in an underpayment of the companies' Maryland income tax. Nordstrom and its subsidiaries appealed the assessments to the Comptroller's Hearings and Appeals Section, which upheld the assessments in Final Determination Letters issued in May 2007. The total tax assessment against NIHC for 2002 and 2003, including the unpaid tax, interest, and a 25 percent penalty, amounted to $1,949,048; the total tax assessment against N2HC for 2002 and 2003, including unpaid tax, interest, and penalty, amounted to $228,007. In both instances, the assessment was based on the amount of income shifted from Nordstrom to the two subsidiaries through the trademark transactions. An alternative assessment was made against Nordstrom related to the same income; the Comptroller stated that it would not be enforced if the assessments of the subsidiaries were upheld on appeal.

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[15](...continued)
$33,307,237, respectively for those years, but did not apportion any of that income to Maryland.

First Visit to Tax Court and Judicial Review

The companies appealed the assessments to the Maryland Tax Court. The Tax Court conducted a hearing at which it received testimony and documentary evidence concerning the trademark transactions. Pertinent to the issue before us, Greta Sedlock, Nordstrom's former Vice President of Tax, testified concerning the companies' returns for 2002 and 2003 that included the income that was subject of the Comptroller's tax assessment. Ms. Sedlock testified that she would have completed those returns differently based upon a letter she had received from tax authorities in New Jersey in 2005, a state that, like Maryland, requires separate company reporting. She said that she had come to the view that, because NIHC filed separate returns from its affiliated corporations, it should have reported the entire gain from the inter-company transactions on its 1999 Maryland return when the §311(b) gain was recognized. According to Ms. Sedlock, she now believed that deferral of the gain over 15 years was only appropriate for the consolidated returns filed under federal law. She apparently believed that she had made a mistake in how she had reported the NIHC's income on the 1999 and subsequent Maryland returns.

The Tax Court issued its decision in October 2008. It viewed the "dispositive issue" as whether there was a sufficient nexus between the two subsidiaries and Maryland, such that imposition of the State income tax on the income of the subsidiaries would not offend the Commerce Clause or the Due Process Clause of the federal Constitution. It viewed the case

primarily as requiring an application of this Court's decision in *Comptroller v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399, *cert. denied*, 540 U.S. 984 *and* 540 U.S. 1090 (2003).

SYL concerned two instances where companies subject to the Maryland corporate income tax each created a wholly owned subsidiary in another jurisdiction and transferred intangible assets to that subsidiary. In each case, the parent company then entered into a licensing agreement with the subsidiary under which the parent company paid royalties to the subsidiary for the use of the intangible assets. The parent companies each deducted the royalty payments in computing income subject to the Maryland income tax and, as a result, were able to reduce their tax liability in Maryland. The respective subsidiaries, which had no assets or employees in Maryland, did not file corporate income tax returns in Maryland. 375 Md. at 80-99. In each case, the Court of Appeals held that the subsidiary lacked economic substance as a business entity separate from its parent and also had a substantial nexus with Maryland. Thus, a portion of each subsidiary's income was subject to the Maryland income tax, based on the extent of its parent company's business in Maryland. *Id.* at 106-09.

The "anti-*Geoffrey* strategy" adopted by Nordstrom had attempted to circumvent the rationale ultimately adopted in *SYL* and similar decisions by using several subsidiaries and a series of transactions between the parent corporation and the various subsidiaries. The Tax Court concluded that, while the transactions involving the Nordstrom subsidiaries were more complicated than those in *SYL,* the results were much the same. "Fundamentally, the

subsidiaries did not act independently, although the financial structure creates an illusion of substance ... NIHC and N2HC lack real economic substance as separate business entities." Accordingly, the Tax Court held that the activities of the subsidiaries must be considered the activities of Nordstrom, which has a nexus with Maryland. It therefore affirmed the assessments against the two subsidiaries. Because the assessments against the subsidiaries were affirmed, the Tax Court rescinded the alternative assessment against Nordstrom.

NIHC sought judicial review in the Circuit Court for Baltimore County, which rendered a decision in August 2009 based on memoranda submitted by the parties.[16] The Circuit Court noted that the sole issue decided by the Tax Court was whether there was a sufficient nexus between Maryland and NIHC to allow taxation of NIHC's income by Maryland under the federal Constitution. The Circuit Court held that the fact that NIHC lacked economic substance did not by itself resolve the question whether there was a sufficient constitutional nexus between its income and the State to satisfy the federal Constitution. It remanded the case to the Tax Court to address whether there was a

[16]N2HC did not seek judicial review of the Tax Court's decision affirming the assessment against it.

The Comptroller sought judicial review of the Tax Court's direction to rescind the alternative assessment against Nordstrom. The Circuit Court later issued an order directing the Tax Court to determine whether Nordstrom had claimed a deduction for any income reported by NIHC. On remand, the Tax Court indicated that it had not found any indication of such a deduction in the record and reiterated its decision to rescind the alternative assessment against Nordstrom. That issue is not before us, as the Comptroller is no longer pursuing the alternative assessment against Nordstrom.

constitutionally sufficient nexus between the §311(b) gain realized by NIHC and business activities in Maryland. If that question were answered in the affirmative, the Circuit Court directed the Tax Court to analyze two additional questions: (1) whether the §311(b) gain constituted taxable income under Maryland tax law; and (2) whether the Maryland requirement of separate entity reporting would prevent taxation of the deferred §311(b) gain in the 2002 and 2003 tax years.

Second Visit to Tax Court and Judicial Review

In July 2010, the Tax Court again upheld the assessment against NIHC and issued an Amended Memorandum of the grounds for its decision. The Tax Court held that Maryland's taxation of the reported income was constitutional as it was not possible to separate the value of the trademarks, their licensing, and the gain recognized by NIHC from Nordstrom's business activities in Maryland. The Tax Court stated that "but for the activities of Nordstrom and its use of the trademarks in Maryland, the gain of NIHC would not have been recognized. Nordstrom's business activities and the use of the intellectual property rights obtained through its agreement with N2HC produced the gain income reported by NIHC." In addition, the Tax Court held that, because Nordstrom's nexus was attributed to NIHC, the income was taxable under Maryland law. Finally, the Tax Court concluded that Maryland's requirement of separate entity income tax returns did not prohibit the taxing of the §311(b) gain "when the income is attributed to the activity of the parent Nordstrom and its use of the

marks in Maryland for the subject years." The Tax Court stated: "NIHC reported the deferred gains as Maryland modified income and the substance of the transaction does not prevent the taxing of income earned in the assessment years because of separate reporting requirements."

NIHC again sought judicial review of the Tax Court decision. In December 2011, the Circuit Court affirmed in part and reversed in part the Tax Court decision. The court agreed with the Tax Court that "the §311(b) gain was the result, in part, of the projected use of the trademarks in Maryland" and that, therefore, there was substantial evidence of a sufficient nexus of the reported income with Maryland. It also concluded that the gain income was "reasonably attributable" to activities in Maryland and therefore taxable under the Maryland income tax law, as that law had been construed to allow taxation "to the bounds permitted by the Constitution."[17] However, the court concluded that Maryland's separate reporting requirement prohibited the Comptroller from assessing the deferred gain reported by NIHC for 2002 and 2003, which the court believed should have been reported with the rest of the gain when it was recognized in 1999. The court therefore reversed the assessment against NIHC.

[17] *Hercules, Inc. v. Comptroller*, 351 Md. 101, 110, 716 A.2d 276 (1998).

Court of Special Appeals Decision

The Comptroller appealed the Circuit Court decision to the Court of Special Appeals. NIHC did not cross-appeal. In an unreported decision, the Court of Special Appeals reversed the Circuit Court judgment. The intermediate appellate court noted that the only issue before it was whether Maryland's separate reporting requirement prevented the taxation of the gain reported on NIHC's 2002 and 2003 returns. The Court of Special Appeals stated that the Circuit Court had incorrectly focused on how the §311(b) gain should have been reported instead of whether it was taxable in the way it had in fact been reported.[18] The court noted

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[18]The Court of Special Appeals explained:

> The Tax Court concluded that Maryland's separate entity reporting requirement did not preclude Maryland's taxing of the §311(b) deferred gain as reported by NIHC on its 2002 and 2003 Maryland tax returns. The circuit court, however, did not address this issue in its review of the Tax Court's decision. Instead, the circuit court focused on the proper way in which the §311(b) gain should be reported, given the conflict between the IRS regulations governing consolidated federal returns (which require the recognition of the gain on a deferred basis over fifteen (15) years), and the Maryland requirement of separate entity returns (which may require the recognition of the gain in its entirety, in the year that the gain was realized). Thus, in the instant case, the circuit court held "*[i]f* the rules relating to deferral of gain on the federal consolidated return were disregarded and *[if*] NIHC reconstructed its federal taxable income *as if* it filed a separate federal income tax return, the §311(b) gain *would not have been reported* in 2002 and 2003."
>
> What NIHC should (or should not) have done in the instant case is not determinative of the issue presented in this appeal. The

(continued...)

that it had not been presented with any law or other authority "that precludes Maryland from taxing income that is constitutionally taxable by Maryland and that is reported by the corporate taxpayer as Maryland modified income on its Maryland income tax return." The Court of Special Appeals found no error in the Tax Court's decision to uphold the assessment against NIHC. Accordingly, it reversed the Circuit Court decision.

The Court of Special Appeals stated that it was expressing no opinion on "the broader issue of whether a corporation's §311(b) gain, which is constitutionally subject to taxation by Maryland, is reportable as Maryland modified income on a deferred basis under Maryland's requirement of separate entity income tax returns, where such deferred gain is reported on the corporation's consolidated federal income tax return."

Petition for Certiorari

NIHC sought a writ of certiorari, which we granted to review the merits of the Tax Court's amended decision in this case.

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[18](...continued)

> key is what NHIC did, in fact, do. The uncontradicted evidence before the Tax Court was that NIHC reported the §311(b) deferred gain as Maryland modified income in its 2002 and 2003 Maryland tax returns. In other words, whether the deferred §311(b) gain should or should not have been reported for the tax years of 2002 and 2003 has been rendered moot by the fact that NIHC reported such gain on its 2002 and 2003 Maryland tax returns.

Discussion

Standard of Review

As the Tax Court is an adjudicative administrative body of the executive branch, its decisions are subject to the same standards of judicial review as adjudicatory decisions of other administrative agencies. *Gore Enterprise Holdings, Inc. v. Comptroller,* 437 Md. 492, 503, 87 A.3d 1263 (2014); *see* TG §13-532(a)(1). A reviewing court may uphold a Tax Court decision only on the findings and reasons given by the Tax Court. *Gore Enterprise*, 437 Md. at 503. Findings of fact are reviewed on a deferential "substantial evidence" standard – *i.e.*, whether the record contains evidence that reasonably supports the agency's conclusion. *Id*. at 504. A reviewing court also accords great weight to the Tax Court's interpretation of the tax laws, but reviews its application of case law without special deference. *Id*. at 504-5.

Deciding What Question is Before Us

Before we can venture an answer to the question before us, we must decide what that question is. As is sometimes the case in appellate litigation, the parties' briefs debate the wording, number, and nature of the question(s) presented.[19] Regardless of the preferred

[19] For example, NIHC contends that the Court of Special Appeals incorrectly rephrased the question raised by the Comptroller, and exceeded the limits of judicial review by basing its decision on a ground not addressed by the Tax Court. The Comptroller argues otherwise and asserts that, even if we address the question preferred by NIHC, the outcome of this appeal is no different. The Comptroller also notes that, while NIHC presented three questions in its petition for certiorari, it has included four questions in its brief, two of which (continued...)

wording of the parties, the issues before us are constrained by the facts found and the legal conclusions drawn in the decision of Tax Court under review, and by the issues preserved by the parties in seeking review of that decision in the courts below.

The present case involves judicial review of a decision of the Tax Court pursuant to TG §13-532. In that context, it is often said that we "look through" the decision of the Court of Special Appeals and the Circuit Court to review directly the agency decision. *See Frey v. Comptroller*, 422 Md. 111, 136-37, 29 A.3d 475 (2011). Thus, our review focuses on the issues addressed by the Tax Court and its reasoning. As indicated above, our review is also limited in another way. As a general rule, we address only issues that have been preserved for review.

In its amended decision, the Tax Court determined that the §311(b) gain recognized by NIHC had a nexus with Maryland through Nordstrom's business activities in Maryland during the pertinent years and was subject to Maryland income taxation for those tax years. The Circuit Court affirmed those holdings. NIHC did not cross appeal as to those issues.[20]

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[19](...continued)
did not appear in its certiorari petition. NIHC responds that the two questions were subsumed in one of the questions it originally presented. We need not referee this debate to identify the question before us.

[20]If we were to address those issues, we would have little trouble coming to the same conclusions as the Tax Court and the Circuit Court. As recounted above, the record demonstrates that the corporate structure and inter-company transactions were designed to shift income away from states like Maryland through the use of entities that, as the Tax Court found, had no economic substance as business entities apart from Nordstrom. Indeed, the consulting firm that designed the transactions for Nordstrom labeled it the "anti-*Geoffrey*
(continued...)

Thus, in the posture of the case before us, there is no question that the income reported on NIHC's Maryland returns for 2002 and 2003 related to Nordstrom's business activities in Maryland during those years and that a portion of that income was subject to taxation in Maryland. A third issue addressed by the Tax Court, at the direction of the Circuit Court, was whether the Maryland statutory requirement that corporate affiliates file separate returns prohibited the Comptroller from taxing the portion of that gain reported on NIHC's 2002 and 2003 returns. The Circuit Court reversed the Tax Court decision on that ground, the Comptroller sought review of only that part of the Circuit Court's decision in its appeal to the Court of Special Appeals, and, following reversal of that issue in the intermediate appellate court, NIHC requested our review of the issue. That is the only portion of the Tax Court decision that has been preserved for review.

Deciding the Question Before Us

The critical holding of the Tax Court appears near the end of its amended decision. After recounting its prior findings and conclusions, including that a portion of NIHC's gain – equivalent to the deferred gain on the federal tax return – had been reported on the

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[20](...continued)
strategy." See footnote 4 above. This strategy, although more convoluted than the scheme devised in the *Geoffrey* case, also relied on transactions with subsidiaries without economic substance separate from the parent corporation to argue that income lacked a nexus with the taxing state. *See also Gore Enterprise Holdings, Inc. v. Comptroller*, 437 Md. 492, 87 A.3d 1263 (2014) (holding that nexus for taxation by Maryland existed when two corporate subsidiaries created to hold intangible assets of the parent corporation lacked economic substance as separate entities).

pertinent Maryland tax returns, the Tax Court addressed whether the Maryland requirement that related corporations file separate tax returns would prohibit taxation of that income. It stated:

> ...The Court finds that there is no such prohibition when the income is attributed to the activity of the parent Nordstrom and its use of the marks in Maryland for the subject years. NIHC reported the deferred gains as Maryland modified income and the substance of the transaction does not prevent the taxing of income earned in the assessment years because of separate reporting requirements.

The Court of Special Appeals reached the same conclusion on the facts of this case,[21] although it explicitly declined to decide the more abstract question of whether a corporation's §311(b) gain is required to be reported as Maryland modified income on a deferred basis on separate Maryland returns when it is reported on a deferred basis on a consolidated federal return. In limiting its holding in that manner, the intermediate appellate court wisely adhered to a maxim of judicial decision-making that counsels against addressing questions abstracted from the facts before the court. *Garner v. Archers Glen Partners Inc*., 405 Md. 43, 46, 949 A.2d 639 (2008) ("an appellate court should use great caution in exercising its discretion to comment gratuitously on issues beyond those necessary to be decided").

[21] In arguing that the intermediate appellate court decided a "different question" from the abstract question it favors, NIHC focuses on the first sentence of the excerpt of the Tax Court decision quoted above, discounts the second sentence which referred to NIHC's reporting of the deferred gain on its 2002 and 2003 returns, and ignores the context of that paragraph in the rest of the Amended Memorandum of Grounds for Decision.

The separate reporting requirement is set forth in TG §10-811, which provides simply that "[e]ach member of an affiliated group of corporations shall file a separate income tax return." A regulation adopted by the Comptroller elaborates that "each separate corporation shall report its taxable income without regard to any consolidation for federal income tax purposes." COMAR 03.04.03.03B(1). The regulations further provide:

> Use of Federal Figures. The starting point for the Maryland return is the taxable income as defined in the Internal Revenue Code and developed on the federal return. Corporations included in a consolidated filing for federal purposes shall file separate Maryland returns and compute separate taxable income.

COMAR 03.04.03.05B. Neither the statute nor the corresponding regulations explicitly address the treatment of §311(b) deferred gain, much less its treatment in the context of a subsidiary corporation that lacks economic substance apart from its parent.

We agree with the Court of Special Appeals that the Tax Court's determination that Maryland's separate reporting requirement for corporations did not prohibit the Comptroller's assessment taxing NIHC's §311(b) gain on a deferred basis should be upheld on judicial review. We start from the premise that the Comptroller's assessment of a tax is presumed to be correct. TG §13-411. The burden is on the taxpayer to show that the assessment is wrong. *Fairchild Hiller Corp. v. Supervisor of Assessments*, 267 Md. 519, 523, 298 A.2d 148 (1973); TG §13-528(b). In computing the assessment, the Comptroller used the figures for Maryland taxable income reported on NIHC's Maryland returns, which correlated with the figures for its federal taxable income reported on NIHC's federal returns

for those years – the "starting point" for computation of its tax liability. The Tax Court found that the ongoing activities of Nordstrom in Maryland, including during the 2002 and 2003 tax years, were responsible for the §311(b) gain reported on NIHC's Maryland tax returns for those years[22] and that NIHC lacked any economic substance apart from Nordstrom.

During the course of this case, NIHC has suggested that the Comptroller should have reached that income in other ways,[23] its preferred method – an application of the separate reporting requirement – being conveniently outside the period of limitations. NIHC argues that Nordstrom should have re-computed a separate federal return for each of the affiliated companies for each of the years in question – called a "pro forma" federal return – and based its Maryland return for each year on the income shown on the corresponding pro forma federal return. NIHC argues that its pro forma federal returns – and thus its Maryland return as well – would have reported the entire §311(b) gain as income in 1999 and that NIHC

[22]It is incontrovertible that the §311(b) gain was derived from the value of the licensing agreement that NIHC transferred as a dividend to N2HC. The value of the licensing agreement ultimately depends on Nordstrom's commercial activities using those trademarks, part of which occur in Maryland. In sum, there is no question at this juncture that the §311(b) gain is related to activities in Maryland, and that a properly apportioned share of it is taxable by Maryland.

[23]In addition to arguing the NIHC's §311(b) gain should have been assessed as to NIHC's 1999 return, which would have been in advance of the Nordstrom business activities that provided the nexus to Maryland, NIHC's counsel also suggested in the Circuit Court that the Comptroller should have disregarded the amortization deduction of N2HC rather than tax the deferred §311(b) gain actually reported by NIHC. As noted above, the annual amount of the N2HC amortization deduction was identical to the annual amount of the deferred §311(b) gain of NIHC assessed by the Comptroller.

should have reported no income from that gain on its pro forma federal returns and Maryland returns for 2002 and 2003. But NIHC never completed any pro forma federal returns, did not amend its Maryland returns in that manner, and, based on the record in this case, did not embrace this manner of reporting its income until tax was assessed by the Comptroller, even though the corporate official in charge of its tax returns claimed to have come to a different conclusion as to how to report its income within the period for amending the returns.

As the Court of Special Appeals held, whether NIHC could have, or should have, reported the entire gain as income subject to Maryland income tax in 1999 – in advance of the business activities of Nordstrom in Maryland in 2002 and 2003 that established the nexus with the income shifted to NIHC– is a separate question from whether the Comptroller could assess income actually reported by NIHC for those years. NIHC complains that the Court of Special Appeals in effect held that it was "bound" by the returns it had filed that it now says were mistaken. It would seem more accurate to say that it is bound by the record in this case.

The separate reporting requirement does not contradict any of the key facts on which the Comptroller's assessment was based:

- the taxpayer lacked economic substance apart from its parent corporation
- the income recognized by the taxpayer was related to the business activities of its parent
- the parent corporation conducted business activities in Maryland during the tax years in question

- the taxpayer reported a portion of the income related to its parent's activities on its Maryland tax returns
- that income was not otherwise taxed by Maryland
- the taxpayer never filed amended returns nor did it submit pro forma federal returns adopting a different method of reporting that income, although it became aware of a different method of filing within the period of limitations

There is no question at this juncture that the transactions carried out under the "anti-*Geoffrey* strategy" shifted income related to Nordstrom's activities in Maryland to NIHC. In essence, NIHC argues that requirement of separate reporting in TG §10-811, together with the statute of limitations, negates the fact that it actually reported part of the income for the tax years in which Nordstrom had business activity in Maryland and absolves it of that tax liability altogether. While the failed anti-*Geoffrey* strategy was an effort to shift income beyond the geographical reach of a state tax collector, NIHC's current argument seeks to shift income to a time period beyond the reach of a state tax collector. It may be that appellate judges are not well-versed in concepts that bend time and space, but we believe this argument is without merit on the facts of this case.

Conclusion

There is no question that the income related to Nordstrom's activities in Maryland during 2002 and 2003 tax years was shifted in part to NIHC. The Comptroller assessed tax on that income as NIHC reported it on its tax returns for those years. However, neither NIHC nor its affiliated corporations has amended their returns to reflect another way of

reporting that income. Essentially, NIHC asks that, because it mistakenly neglected to report its entire gain and pay the appropriate tax on its 1999 Maryland return, it should be forgiven any tax liability on that income, even though it reported a portion of that income on its 2002 and 2003 returns. On the facts of this case, the separate reporting requirement does not eliminate the tax liability for the income reported, properly subject to tax, and not previously taxed. We hold that, on the record before the Tax Court, NIHC did not carry its burden of showing that the Comptroller's assessment was wrong.

JUDGMENT OF THE COURT OF SPECIAL APPEALS AFFIRMED. COSTS TO BE PAID BY PETITIONER.

13-1032 DIRECT MARKETING ASSOCIATION V. BROHL

DECISION BELOW: 735 F.3d 904

LOWER COURT CASE NUMBER: 12-1175

QUESTION PRESENTED:

The Tax Injunction Act, 28 U.S.C. § 1341 ("TIA'), provides, with regard to federal court jurisdiction, that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." The Tenth Circuit Court of Appeals held that the TIA bars the exercise of federal court jurisdiction over a suit brought by the Petitioner challenging the constitutionality of a Colorado law, Colo. Rev. Stat. §§ 39-21-112(3.5)(c) & (d), which imposes informational notice and reporting requirements, and substantial penalties for non-compliance, on out-of-state retailers that do not collect Colorado sales tax.

The Tenth Circuit's ruling diverges from this Court's leading precedent and creates a split among the Circuit Courts of Appeals regarding the scope of the TIA's limitation on federal court jurisdiction, presenting the following question:

Whether the TIA bars federal court jurisdiction over a suit brought by non-taxpayers to enjoin the informational notice and reporting requirements of a state law that neither imposes a tax, nor requires the collection of a tax, but serves only as a secondary aspect of state tax administration?

CERT. GRANTED 7/1/2014

FILED
United States Court of Appeals
Tenth Circuit

August 20, 2013

Elisabeth A. Shumaker
Clerk of Court

PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

DIRECT MARKETING ASSOCIATION,

Plaintiff - Appellee,

v.

BARBARA BROHL, in her capacity as Executive Director, Colorado Department of Revenue,

Defendant – Appellant,

and

MULTISTATE TAX COMMISSION,

Amicus – Curiae.

No. 12-1175

**APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(D.C. NO. 1:10-CV-01546-REB-CBS)**

Melanie J. Snyder, Deputy Attorney General (John W. Suthers, Attorney General; Daniel D. Domenico, Solicitor General; Stephanie Lindquist Scoville, Senior Assistant Attorney General; and Grant T. Sullivan, Assistant Attorney General, with her on the briefs), Denver, Colorado, appearing for Appellant.

George S. Isaacson (Matthew P. Schaefer with him on the briefs), Brann & Isaacson, Lewiston, Maine, appearing for Appellee.

Sheldon Laskin, Counsel, and Shirley Sicilian, General Counsel, Washington, D.C., filed an amicus curiae brief on behalf of Multistate Tax Commission.

Before **BRISCOE,** Chief Judge, **GORSUCH** and **MATHESON,** Circuit Judges.

MATHESON, Circuit Judge.

This appeal arises from Colorado's efforts to collect sales and use taxes during the expansion of e-commerce.

Appellant Barbara Brohl, Executive Director of the Colorado Department of Revenue (the "Department"), appeals from an order enjoining the enforcement of state notice and reporting requirements imposed on retailers who do not collect taxes on sales to Colorado purchasers ("non-collecting retailers"). Most, if not all, of these non-collecting retailers sell products to Colorado purchasers by mail or online.

Appellee Direct Marketing Association ("DMA")—a group of businesses and organizations that market products via catalogs, advertisements, broadcast media, and the Internet—urges us to uphold the district court's determination that Colorado's notice and reporting obligations are unconstitutional. The district court concluded that Colorado's requirements for non-collecting retailers discriminated against and placed undue burdens on interstate commerce, in violation of the Commerce Clause of the United States Constitution. It therefore entered a permanent injunction prohibiting enforcement of the state requirements.

The issue in this appeal is whether Colorado's notice and reporting obligations for

non-collecting retailers violate the Commerce Clause. However, we do not reach that merits question. Because the Tax Injunction Act, 28 U.S.C. § 1341, deprived the district court of jurisdiction to enjoin Colorado's tax collection effort, we remand to the district court to dismiss DMA's Commerce Clause claims.

I. BACKGROUND

A. *Colorado's Sales and Use Taxes*

Colorado imposes a 2.9 percent tax on the sale of tangible goods within the state. Colo. Rev. Stat. §§ 39-26-104(1)(a), -106(1)(a)(II). Retailers with a physical presence in the state are required by law to collect sales tax from purchasers[1] and remit it to the Department. *Id.* § 39-26-105, -106(2)(a). The sales tax statute imposes additional duties on Colorado retailers such as recordkeeping, *id.* § 39-26-116, and penalties for deficient remittance of sales tax, *id.* § 39-26-115.

If Colorado purchasers have not paid sales tax on tangible goods—as occurs in some online and mail-order purchases from retailers with no in-state physical presence—they must pay a 2.9 percent use tax "for the privilege of storing, using, or consuming" the goods in Colorado. *Id.* § 39-26-202(1)(b). The use tax complements the sales tax and is designed to "prevent[] consumers of retail products from purchasing out of state in order to avoid paying a Colorado sales tax." *Walgreen Co. v. Charnes*, 819 P.2d 1039, 1043 (Colo. 1991) (en banc); *see also Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S.

[1] We use the terms "purchasers," "consumers," and "customers" interchangeably.

64, 66 (1963) ("[T]he purpose of . . . a sales-use tax scheme is to make all tangible property used or consumed in [a] State subject to a uniform tax burden irrespective of whether it is acquired within the State.").

Although Colorado's sales and use taxes have equivalent rates, they are collected differently. Whereas retailers with a physical presence in the state must collect and remit sales tax to the Department, the onus is on the purchaser to report and pay use tax. *See J.A. Tobin Const. Co. v. Weed*, 407 P.2d 350, 353 (Colo. 1965) (en banc). This difference results from the Supreme Court's bright-line rule in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In *Quill*, the Court reaffirmed that it is unconstitutional under the "negative" or "dormant" aspect of the Commerce Clause for a state to require a retailer with no in-state physical presence to collect the state's sales or use taxes. *Id.* at 315-18 (reaffirming Commerce Clause holding in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967)). Because *Quill* prohibits Colorado from forcing retailers with no in-state physical presence to collect and remit taxes on sales to Colorado consumers, the state requires its residents to report and pay use taxes to the Department with their income tax returns. *See* Colo. Rev. Stat. § 39-26-204(1)(b). The failure to report and pay use tax is a criminal offense. *Id.* § 39-26-206; *id.* § 39-21-118.

Nonetheless, use tax collection is elusive. Most Colorado residents do not report or remit use tax despite the legal obligation to do so. A 2010 report submitted as part of this litigation estimated that Colorado state and local governments would lose $172.7

million in 2012 because of residents' failure to pay use tax on e-commerce purchases from out-of-state, non-collecting retailers.

B. ***Notice and Reporting Requirements***

To increase use tax collection, in 2010 the Colorado legislature enacted statutory requirements for non-collecting retailers.[2] The statute and its implementing regulations impose three principal obligations on non-collecting retailers whose gross sales in Colorado exceed $100,000: they must (1) provide transactional notices to Colorado purchasers, (2) send annual purchase summaries to Colorado customers, and (3) annually report Colorado purchaser information to the Department.

Under the first requirement, non-collecting retailers must "notify Colorado purchasers that sales or use tax is due on certain purchases . . . and that the state of Colorado requires the purchaser to file a sales or use tax return." Colo. Rev. Stat. 39-21-112(3.5)(c)(I). The notice must be included in every transaction with a Colorado purchaser, 1 Colo. Code Regs. § 201-1:39-21-112.3.5(2)(a), and shall inform the purchaser that (1) the retailer has not collected sales or use tax, (2) the purchase is not exempt from Colorado sales or use tax, and (3) Colorado law requires the purchaser to

[2] A "non-collecting retailer" is defined as "[a] retailer that . . . sells goods to Colorado purchasers and that does not collect Colorado sales or use tax." 1 Colo. Code Regs. § 201-1:39-21-112.3.5(1)(a)(i). Non-collecting retailers who made less than $100,000 in total gross sales in Colorado in the previous calendar year, and who reasonably expect gross sales in the current calendar year to be less than $100,000, are exempt from the notice and reporting obligations. *Id.* § 201-1:39-21-112.3.5(1)(a)(iii).

file a sales or use tax return and to pay tax owed. *Id.* § 201-1:39-21-112.3.5(2)(b).[3] According to the Department, the transactional notice "serves to educate consumers about their state use tax liability with the aim of increasing voluntary compliance." Aplt. Br. at 12.

Under the second requirement, non-collecting retailers must mail annual notices to Colorado customers who purchased more than $500 in goods from them in the preceding calendar year. 1 Colo. Code Regs. § 201-1:39-21-112.3.5(3)(a), (c). The summary must be sent by January 31 of each year and the envelope containing it must be "prominently marked with the words 'Important tax document enclosed.'" *Id.* § 201-1:39-21-112.3.5(3)(a)(i), (vi). The summary must inform Colorado consumers of purchase dates, items bought, and the amount of each purchase made in the preceding calendar year. *Id.* § 201-1:39-21-112.3.5(3)(a)(ii). The annual summary tells purchasers they have a duty to "file a sales or use tax return at the end of every year" in Colorado and must inform customers that the retailer is required to report to the Department the customers' total purchase amounts from the preceding calendar year. *Id.* § 201-1:39-21-112.3.5(3)(a)(iii), (iv). According to the Department, the annual summary "arms the consumer with accurate information to facilitate reporting and paying the use tax." Aplt. Br. at 13.

[3] Non-collecting retailers may provide a more generalized notice if they are required to comply with a similar practice in another state. *Id.* § 201-1:39-21-112.3.5(2)(e). The transactional notice also may take the form of a prominent link during an online purchase that states, "See important sales tax information regarding the tax you may owe directly to your state." *Id.* § 201-1:39-21-112.3.5(2)(d).

Third, non-collecting retailers must annually report information on Colorado purchasers to the Department. Colo. Rev. Stat. § 39-21-112(3.5)(d)(II)(A). The annual report shall include purchasers' names, billing addresses, shipping addresses, and total purchase amounts for the previous calendar year. 1 Colo. Code Regs. § 201-1:39-21-112.3.5(4)(a). According to the Department, this customer information report "allows [it] to pursue audit and collection actions against taxpayers who fail to pay the tax" and "is designed to increase voluntary consumer compliance with state tax laws because consumers know that a third party has reported their taxable activity to the taxing authority." Aplt. Br. at 13.

Non-collecting retailers who do not comply with any one of Colorado's notice and reporting obligations are subject to penalties. Colo. Rev. Stat. § 39-21-112(3.5)(c)(II), (d)(III)(A)-(B). Alternatively, retailers may choose to collect and remit sales tax from Colorado purchasers to forgo the notice and reporting obligations.

C. ***Procedural History***

In June 2010, DMA sued the Department's executive director,[4] challenging the constitutionality of Colorado's notice and reporting requirements. Claims I and II of DMA's complaint alleged that Colorado's statutory and regulatory obligations are unconstitutional under the Commerce Clause because they (1) discriminate against

[4] At the time, the executive director was Roxy Huber. Ms. Brohl was later substituted as the defendant in this litigation.

interstate commerce ("Discrimination Claim"), and (2) impose undue burdens on interstate commerce ("Undue Burden Claim").[5]

The district court granted DMA a preliminary injunction prohibiting the enforcement of the notice and reporting requirements. The parties then agreed to an expedited process for resolving the two Commerce Clause claims and filed cross-motions for summary judgment on those claims.

On March 30, 2012, the district court granted DMA's motion for summary judgment and denied the Department's motion for summary judgment. On the Discrimination Claim, the court concluded that the notice and reporting requirements facially discriminate against interstate commerce. It held these requirements are unconstitutional because "[t]he record contains essentially no evidence to show that the legitimate interests advanced by the [Department] cannot be served adequately by reasonable nondiscriminatory alternatives." *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS, 2012 WL 1079175, at *6 (D. Colo. Mar. 30, 2012).

On the Undue Burden Claim, the district court relied on *Quill*'s bright-line rule that state governments cannot constitutionally require businesses without an in-state physical presence to collect and remit sales or use taxes. The district court acknowledged that Colorado's notice and reporting requirements do not obligate out-of-state retailers to

[5] DMA's First Amended Complaint asserted six other claims under the United States and Colorado Constitutions. The district court stayed these claims pending the resolution of Claims I and II. Only Claims I and II are before this court on appeal.

collect and remit taxes. But it reasoned that the notice and reporting requirements place burdens on out-of-state retailers that "are inextricably related in kind and purpose to the burdens condemned in *Quill*." *Id.* at *8. These burdens, the district court concluded, would unconstitutionally interfere with interstate commerce.

In the same order, the court entered a permanent injunction prohibiting enforcement of the notice and reporting requirements. In granting injunctive relief, the district court said DMA had achieved actual success on the merits because the court had granted summary judgment on the Discrimination and Undue Burden Claims.

Because DMA's non-Commerce Clause claims remained unresolved, the district court said it would "address in a separate order the parties' request that [it] certify this order as a final judgment under Fed. R. Civ. P. 54(b)," from which the Department could appeal. *Id.* at *11; *see also* 28 U.S.C. § 1291. However, the Department filed its notice of appeal before the district court certified the order as final under Fed. R. Civ. P. 54(b). We nevertheless may consider the Department's appeal from the district court's entry of a permanent injunction under 28 U.S.C. § 1292(a)(1) (providing jurisdiction over interlocutory orders granting injunctions).

II. **DISCUSSION**

The issue on appeal is whether Colorado's notice and reporting requirements for non-collecting retailers violate the dormant Commerce Clause. Before addressing that issue, however, we must determine whether the Tax Injunction Act ("TIA"), 28 U.S.C. § 1341, precludes federal jurisdiction over DMA's claims. We conclude that it does and

do not reach the merits of this appeal.

A. ***Tax Injunction Act***

The TIA provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341. "The statute has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations." *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 522 (1981) (quotations omitted). It therefore serves as a "broad jurisdictional barrier" that "limit[s] drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Arkansas v. Farm Credit Servs. of Cent. Ark.*, 520 U.S. 821, 825, 826 (1997). Because the TIA is a jurisdictional limitation, we must determine whether it prohibits our consideration of this appeal regardless of whether it was raised in the district court. *See Oklahoma ex rel. Okla. Tax Comm'n v. Int'l Registration Plan, Inc.*, 455 F.3d 1107, 1111 (10th Cir. 2006); *see also Folio v. City of Clarksburg*, 134 F.3d 1211, 1214 (4th Cir. 1998) ("This statutory provision is a jurisdictional bar that is not subject to waiver, and the federal courts are duty-bound to investigate the application of the Tax Injunction Act regardless of whether the parties raise it as an issue.").

The TIA prohibits our jurisdiction if (1) DMA's action seeks to "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law," 28 U.S.C. § 1341, and (2) "a plain, speedy and efficient remedy may be had in the courts of such

State," *id.* We address these issues in turn.

1. **Does DMA seek to enjoin, suspend, or restrain the assessment, levy or collection of a state tax?**

The TIA divests federal district courts of jurisdiction over actions that seek to "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." 28 U.S.C. § 1341. This broad language prohibits federal courts from interfering with state tax administration through injunctive relief, declaratory relief, or damages awards. *See California v. Grace Brethren Church*, 457 U.S. 393, 407-08 (1982); *Marcus v. Kan. Dep't of Revenue*, 170 F.3d 1305, 1309 (10th Cir. 1999). The TIA "does not limit any substantive rights to enjoin a state tax but requires only that they be enforced in a state court rather than a federal court." *Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc.*, 651 F.3d 722, 725 (7th Cir. 2011).

In its brief, DMA argues the TIA does not preclude federal jurisdiction here because DMA (1) is not a taxpayer seeking to avoid a tax, and (2) challenges notice and reporting requirements, not a tax assessment.

a. *Non-taxpayer lawsuits*

DMA argues it is not a taxpayer seeking to avoid state taxes and thus the TIA does not apply. Its argument rests on *Hibbs v. Winn*, 542 U.S. 88 (2004), where the Supreme Court stated that the TIA is triggered when "state taxpayers seek federal-court orders enabling them to avoid paying state taxes." *Id.* at 107. Relying on our precedent interpreting *Hibbs*, we disagree that the TIA applies only when taxpayers seek to avoid a

state tax in federal court.

The plaintiffs in *Hibbs* were Arizona taxpayers who brought an Establishment Clause challenge in federal court to a state tax credit for contributions to "school tuition organizations." *Id.* at 94-95. The plaintiffs did not challenge a tax imposed on them, but a tax benefit to others. *Id.* at 108. The Supreme Court determined the TIA did not bar such a lawsuit.

The Court observed that Congress enacted the TIA to "direct[] taxpayers to pursue refund suits instead of attempting to restrain [state tax] collections" through federal lawsuits. *Id.* at 104. "In short," the Court said, "Congress trained its attention on taxpayers who sought to avoid paying their tax bill by pursuing a challenge route other than the one specified by the taxing authority." *Id.* at 104-05.

Beyond this discussion of taxpayer lawsuits, the *Hibbs* Court explained that the TIA applies to federal court relief that "would . . . operate[] to reduce the flow of state tax revenue"—i.e., federal lawsuits that would inhibit state tax assessment, levy, or collection. *Id.* at 106. According to the statute's legislative history, Congress enacted the TIA with "state-revenue-protective objectives," including prohibiting "taxpayers, with the aid of a federal injunction, from withholding large sums, thereby disrupting state government finances." *Id.* at 104; *see also id.* at 105 n.7 ("The TIA . . . proscribes interference only with those aspects of state tax regimes that are needed to produce revenue—i.e., assessment, levy, and collection."). The Court noted that the *Hibbs* plaintiffs did not challenge a state-revenue-producing measure—they sought to invalidate

a *tax credit* the state gave to taxpayers—and that nothing in the TIA prohibited a third party from challenging a state tax benefit in federal court. *See id.* at 107-08.

Although *Hibbs* states that the TIA applies to "cases in which state taxpayers seek federal-court orders enabling them to avoid paying state taxes," *id.* at 107, we have not interpreted it as holding that the TIA applies only to taxpayer suits. For instance, in *Hill v. Kemp*, 478 F.3d 1236 (10th Cir. 2007), we applied the TIA outside the context of a taxpayer seeking to avoid taxes. In *Hill*, Oklahoma motorists and abortion-rights supporters sought to enjoin Oklahoma's statutory scheme for specialty vehicle license plates. *Id.* at 1239. The plaintiffs argued that Oklahoma unconstitutionally discriminated against their viewpoint by giving more favorable terms and conditions to drivers who wanted specialty plates with anti-abortion messages. *Id.*

We agreed with the district court that the TIA barred the plaintiffs' challenge because Oklahoma's specialty license plate scheme imposed revenue-generating charges, which we viewed as taxes. *Id.* at 1244-45. To enjoin the "entire specialty plate regime . . . or even to enjoin a portion of it," we said, "would deny Oklahoma the use of significant funds" used for a variety of state initiatives. *Id.* at 1247. Such a result "would implicate exactly the sort of federalism problems the TIA was designed to ameliorate." *Id.*; *see also Tully v. Griffin, Inc.*, 429 U.S. 68, 73 (1976) ("[T]he statute has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.").

The plaintiffs in *Hill* argued that, under *Hibbs*, the TIA did not apply because they

did not "challenge an assessment imposed on them, but rather assessments imposed on and paid by other persons or entities"—i.e., they were not taxpayers trying to avoid a tax. 478 F.3d at 1249. We disagreed with this reading of *Hibbs*. We saw "[n]othing in the language of the TIA indicat[ing] that our jurisdiction to hear challenges to state taxes can be turned like a spigot, off when brought by taxpayers challenging their own liabilities and on when brought by third parties challenging the liabilities of others." *Id.*

We acknowledged that in *Hibbs* the Court "did point out that TIA cases typically involve challenges brought by state taxpayers seeking to avoid their own state tax liabilities." *Id.* But we noted that some lower-court cases applied the TIA to suits by third parties who sought to disrupt state tax collection and that the *Hibbs* Court did not criticize these decisions. *Id.* at 1249 & n.11 (citing *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 132 (4th Cir. 2000)). We interpreted *Hibbs* as holding that the "essential problem with the defendant's assertion that the TIA barred the suit . . . lay in the fact that the plaintiff[s] . . . simply did not seek to enjoin the *levy or collection* of any *tax* . . . but instead sought to challenge the *provision* of a *tax credit.*" *Id.* at 1249. The upshot of *Hibbs*, we said, is that "giving away a tax credit is a very different thing than assessing, levying or collecting a tax." *Id.* at 1249. The nature of the plaintiff was not the "essential and dispositive distinction under the Supreme Court's teaching in *Hibbs*." *Id.*

Accordingly, we have not interpreted *Hibbs* as holding that the TIA applies only when taxpayers seek to avoid a state tax. Rather, the key question is whether the plaintiff's lawsuit seeks to prevent "the State from exercising its sovereign power to

collect . . . revenues." *Id.*[6] This interpretation adheres to *Hibbs*'s instruction that the primary purpose of the TIA is to "shield[] state tax collections from federal-court restraints." 542 U.S. at 104; *see also Ashton v. Cory*, 780 F.2d 816, 822 (9th Cir. 1986) ("The Supreme Court has repeatedly stated that the principal purpose of the Tax Injunction Act was to curtail federal court interference with state revenue collection procedures.").

Contrary to DMA's position, it cannot avoid the TIA merely because it is not a taxpayer challenging tax payment.

b. *Notice and reporting obligations*

DMA next argues that it seeks to avoid notice and reporting obligations, not a tax. It insists that "[t]he fact that such obligations relate to use tax owed by Colorado consumers does not bring the DMA's suit . . . under the umbrella of the TIA as a suit seeking to enjoin the collection of a state tax." Aplee. Br. at 4.

But the TIA bars more than suits that would enjoin tax collection. It also prohibits federal lawsuits that would "*restrain* the . . . collection" of a state tax. 28 U.S.C. § 1341 (emphasis added). The issue is whether DMA's attack on Colorado's notice and

[6] In *Hill*, we stated that "our understanding of *Hibbs* accords with the views expressed by the Fifth Circuit." 478 F.3d at 1249 n.12. We cited *Henderson v. Stalder*, 407 F.3d 351 (5th Cir. 2005). In *Henderson*, the Fifth Circuit explained that "*Hibbs* opened the federal courthouse doors slightly notwithstanding the limits of the TIA, but it did so only where (1) a third party (not the taxpayer) files suit, *and* (2) the suit's success will enrich, not deplete, the government entity's coffers." *Id.* at 359 (emphasis added). In other words, if a non-taxpayer challenges a tax measure but its challenge would deplete state revenues, *Hibbs* does not prevent the TIA's application.

reporting obligations would "restrain" Colorado's tax collection.

i. Suits that restrain tax collection

In enacting the TIA, Congress chose to prohibit three forms of interference with state tax collection: "enjoin[ing], suspend[ing], or restrain[ing.]" *Id.* Its use of the disjunctive "or" suggests each term has a distinct meaning. *See Garcia v. United States*, 469 U.S. 70, 73 (1984) ("Canons of construction indicate that terms connected in the disjunctive . . . be given separate meanings."). The terms "enjoin" and "suspend" suggest entirely arresting tax collection, but "restrain" has a broader ordinary meaning. *See Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.").

Under most definitions, "restrain" means to limit, restrict, or hold back. *See* Webster's Third New International Dictionary 1936 (1976) (defining "restrain" as "to limit or restrict . . . a particular action or course" and "to moderate or limit the force, effect, development, or full exercise of"); American Heritage Dictionary of the English Language 1497 (2011) (defining "restrain" as "[t]o hold back or keep in check"); *see also* Black's Law Dictionary 1429 (9th ed. 2009) (defining "restraint" as "[c]onfinement, abridgment, or limitation"). We accept this ordinary meaning of "restrain," cognizant of the Supreme Court's instruction that the TIA is a broad jurisdictional prohibition. *See Farm Credit Servs.*, 520 U.S. at 825; *Rosewell*, 450 U.S. at 524; *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 470 (1976); *see also Brooks v. Nance*, 801 F.2d 1237, 1239 (10th Cir. 1986); *Gasparo v. City of New York*, 16

F. Supp. 2d 198, 216 (E.D.N.Y. 1998) (The TIA "has not been narrowly construed, but rather constitutes a broad restriction on federal court jurisdiction." (quotations omitted)).

A lawsuit seeking to enjoin state laws enacted to ensure compliance with and increase use tax collection, like DMA's challenge here, would "restrain" state tax collection. Such a lawsuit, if successful, would limit, restrict, or hold back the state's chosen method of enforcing its tax laws and generating revenue. Federalism concerns, which the TIA seeks to avoid, arise not only when a state tax is challenged in federal court, but also when the means for collecting a state tax are targeted there. The TIA's use of the term "restrain" allows federal courts to weed out lawsuits, such as DMA's, that attempt to undermine state tax collection.

Although DMA does not directly challenge a tax, it contests the *way* Colorado wishes to collect use tax. This court has said that the TIA "cannot be avoided by an attack on the administration of a tax as opposed to the validity of the tax itself." *Brooks*, 801 F.2d at 1239. In making this statement, we agreed with *Czajkowski v. Illinois*, 460 F. Supp. 1265 (N.D. Ill. 1977), which applied the TIA to a challenge to state cigarette tax enforcement, even though it was "arguable that plaintiffs [were] only seeking to enjoin the state from using unconstitutional methods and procedures to collect the taxes, rather than the collection of taxes itself." *Id.* at 1272.

We acknowledge that DMA's suit is unlike TIA cases in which a plaintiff asks a federal court to invalidate and enjoin a state tax. Even if DMA's constitutional attack on the notice and reporting obligations were successful, Colorado consumers would still owe

use taxes by law. But the state-chosen method to secure those taxes would be compromised, curbing Colorado's ability to collect revenue. The inquiry under the TIA is whether DMA's lawsuit would *restrain* state tax collection. Although DMA's lawsuit differs from the prototypical TIA case, its potential to restrain tax collection triggers the jurisdictional bar.

DMA suggests that the obligations imposed on non-collecting retailers merely "relate to use tax owed by Colorado consumers." Aplee. Br. at 4. We disagree with DMA's characterization and attempt to distance the notice and reporting obligations from the collection of a state tax. Colorado enacted the notice and reporting obligations to increase taxpayers' compliance with use tax laws and thereby increase use tax collection. Even the title of the bill that later became law reflects its tax collection purpose: "An Act Concerning the *Collection of Sales and Use Taxes* on Sales Made by Out-of-State Retailers." *Id.* at 5 (emphasis added). One of the challenged requirements, the annual customer information reports sent to the Department, would aid the Department's auditing of taxpayers, a significant tax collection mechanism. Indeed, the tax collection goal of the notice and reporting requirements is apparent because out-of-state retailers who voluntarily collect tax on Colorado purchases are exempt.

The purposes of the TIA apply both to a lawsuit that would directly enjoin a tax and one that would enjoin a procedure required by the state's tax statutes and regulations that aims to enforce and increase tax collection. Either action interferes with state revenue collection and falls within the "traditional heartland of TIA cases" that dismiss

federal lawsuits to protect state coffers. *Hill*, 478 F.3d at 1250; *see also Brooks*, 801 F.2d at 1239 (the TIA "cannot be avoided by an attack on the administration of a tax as opposed to the validity of the tax itself"); *Jerron W., Inc. v. State of Cal., State Bd. of Equalization*,129 F.3d 1334, 1337 (9th Cir. 1997) (applying the TIA to an action seeking to enjoin a hearing and administrative proceedings that were integral to the state's sales tax assessment and collection scheme).

Other courts have applied the TIA to attacks on tax collection methods, rather than taxes themselves. In *Gass v. County of Allegheny*, 371 F.3d 134 (3d Cir. 2004), the Third Circuit held that the TIA barred a lawsuit challenging a state tax appeals procedure. Although the appellant argued that its lawsuit did not affect the state's ability to collect tax, the appellate court concluded that the "appeal process is directed to the . . . ultimate goal and responsibility of determining the proper amount of tax to assess" and thus fell within the TIA. *Id.* at 136.

Similarly, the Ninth Circuit has applied the TIA to bar a suit that would have prohibited disclosure of tax information to state taxing authorities. *Blangeres v. Burlington N., Inc.*, 872 F.2d 327, 328 (9th Cir. 1989) (per curiam). The lawsuit sought to withhold "earnings records and other tax-related information to the Idaho and Montana taxing authorities." *Id.* As here, the taxpayer would have continued to owe tax, but the states would have been deprived of the means to calculate and collect it. The Ninth Circuit said, "[t]he fact that the injunction would restrain assessment indirectly rather than directly does not make the [TIA] inapplicable." *Id.*; *see also RTC Commercial*

Assets Trust 1995-NP3-1 v. Phoenix Bond & Indem. Co., 169 F.3d 448, 454 (7th Cir. 1999) ("[T]he TIA withdraws federal jurisdiction even over actions that would indirectly restrain the assessment, levy, or collection of taxes."). The Ninth Circuit has since explained that whether the TIA applies depends on "the *effect* of federal litigation on the state's ability to collect revenues, and will only bar the adjudication of a federal constitutional claim in federal court if a judgment for the plaintiffs will hamper a state's ability to raise revenue." *Winn v. Killian*, 307 F.3d 1011, 1017 (9th Cir. 2002), *aff'd sub nom. Hibbs*, 542 U.S. 88. We have little problem concluding that DMA's lawsuit would hamper Colorado's ability to raise revenue.

ii. DMA's additional arguments

DMA responds that the Supreme Court has cautioned that the TIA is not a "sweeping congressional direction to prevent federal-court interference with all aspects of state tax administration." *Hibbs*, 542 U.S. at 105. We have acknowledged this point, *see Chamber of Commerce v. Edmondson*, 594 F.3d 742, 761 (10th Cir. 2010), and continue to do so here. But in making this pronouncement, the Supreme Court was distinguishing between federal lawsuits that would not curb state revenue collection, and therefore would not fall within the TIA, and "[f]ederal-court relief [that] . . . [would] reduce the flow of state tax revenue," and thus trigger the TIA. *Hibbs*, 542 U.S. at 106. DMA's Commerce Clause claims fall within the latter category.

DMA also cites two federal circuit court cases to argue that our interpretation of the TIA is overly broad: *United Parcel Service Inc. v. Flores-Galarza* ("*UPS*"), 318 F.3d

323, 330-32 (1st Cir. 2003), and *Wells v. Malloy*, 510 F.2d 74, 77 (2d Cir. 1975).

In *UPS*, the First Circuit addressed whether the Butler Act, a close relative of the TIA, deprived it of jurisdiction over a challenge to Puerto Rico's interstate package delivery scheme. The Butler Act provides that "[n]o suit for the purpose of restraining the assessment or collection of any tax imposed by the laws of Puerto Rico shall be maintained in the United States District Court for the District of Puerto Rico." 48 U.S.C. § 872. UPS challenged Puerto Rico's statutory scheme prohibiting an interstate carrier from delivering a package unless the recipient presented a certificate of excise tax payment. *See UPS*, 318 F.3d at 326. Alternatively, interstate carriers could prepay excise tax and seek reimbursement from package recipients, but this option imposed expensive and burdensome statutory and regulatory obligations. *Id.*

The First Circuit determined the Butler Act did not bar UPS's action. It reasoned that "UPS sought to enjoin only those provisions . . . that prohibit or interfere with the delivery of packages. UPS did not challenge the amount or validity of the excise tax, nor the authority of the Secretary to assess or collect it." *Id.* at 330-31. The court also said that Puerto Rico's package "delivery ban targets third parties instead of those who owe the tax." *Id.* at 331. It found that Puerto Rico's laws produced excise tax revenue "indirectly through a more general use of coercive power" and did not create "a system of tax collection within the meaning of the Butler Act." *Id.* (quotations omitted).

Even if *UPS* counsels against applying the TIA here, we decline to follow it. Much of *UPS*'s reasoning conflicts with our own binding case law. For instance, *UPS*

found it important that the plaintiff did "not challenge the amount or validity of the excise tax," *id.* at 330-31, but we have said the TIA "cannot be avoided by an attack on the administration of a tax as opposed to the validity of the tax itself." *Brooks*, 801 F.2d at 1239. The *UPS* court also declined to apply the Butler Act because Puerto Rico's laws targeted third parties, not taxpayers. But, as discussed above, we recognized in *Hill* that the TIA can apply to third-party lawsuits that enjoin, suspend, or restrain tax collection. *See* 478 F.3d at 1249. Indeed, much of the reasoning in *UPS* would have counseled against applying the TIA to the license plate lawsuit in *Hill*.

DMA also cites *Wells v. Malloy*, 510 F.2d 74, 77 (2d Cir. 1975) (Friendly, J.). In *Wells*, the plaintiff sought to enjoin a Vermont provision that required suspension of his driver's license for failure to pay motor vehicle taxes. *Id.* at 76. The plaintiff did not dispute owing taxes. *Id.* The district court determined the TIA barred the action, but the Second Circuit disagreed.

The court concluded the plaintiff was not seeking to restrain the collection of a tax. It said, "'Collection,' of course, could be read broadly to include anything that a state has determined to be a likely method of securing payment." *Id.* at 77. But the court interpreted "collection" to mean "methods similar to assessment and levy . . . that would produce money or other property directly, rather than indirectly through a more general use of coercive power." *Id.*

Like *Wells*, we do not interpret the TIA as applying to any action challenging a state law that could possibly secure tax payment. But here DMA challenges laws enacted

to notify consumers of their duty to pay use tax and to garner information on consumer purchases to ensure tax compliance through audits. Its lawsuit targets measures that attempt to ensure tax compliance in the first instance, not sanctions imposed after a taxpayer has admittedly refused to pay taxes. Colorado's laws are not a reactive and punitive "general use of coercive power" to entice tax payment from individuals who admittedly refuse to pay, and we therefore do not think *Wells* applies here.

Finally, we mention one recent development. After oral argument in this case, this court considered the application of the Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421, in *Hobby Lobby Stores, Inc. v. Sebelius*, -- F.3d --, 2013 WL 3216103 (10th Cir. June 27, 2013) (en banc). Using somewhat similar language to the TIA, the AIA states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." 26 U.S.C. § 7421(a). Whereas the TIA protects state tax measures, the AIA "protects the [federal] Government's ability to collect a consistent stream of revenue, by barring litigation to enjoin or otherwise obstruct the collection of taxes." *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2582 (2012).

In *Hobby Lobby*, two corporations challenged a federal requirement that they provide employees with health insurance coverage for certain contraceptive methods. 2013 WL 3216103 at *1. Failure to comply with the federal requirement exposed the corporations to a "tax" under 26 U.S.C. § 4980. *Id.* at *7. We considered whether the

AIA barred the corporations' action because their suit might enjoin a tax on them for non-compliance with the health care coverage requirement.

We explained that the corporations were "not seeking to enjoin the collection of taxes or the execution of any IRS regulation; they [were] seeking to enjoin the enforcement, by whatever method, of one HHS regulation" regarding contraceptive coverage. *Id.*; *see also id.* ("[T]he corporations' suit is not challenging the IRS's ability to collect taxes."). The "tax [was] just one of many collateral consequences" of non-compliance with the federal contraceptive-coverage requirement. *Id.* Moreover, "[t]he statutory scheme ma[de] clear that the tax at issue [was] no more than a penalty for violating regulations . . . and the AIA does not apply to the exaction of a purely regulatory tax." *Id.* at *8 (quotations omitted).[7]

Our position in this appeal is consistent with the analysis in *Hobby Lobby*. The corporations in *Hobby Lobby* challenged a health insurance regulation and a possible penalty for failing to comply with that regulation. To the extent that the penalty

[7] In using the term "regulatory tax," the *Hobby Lobby* court appears to have drawn a distinction between a "classic tax [that] sustains the essential flow of revenue to the government," *Marcus v. Kan. Dep't of Rev.*, 170 F.3d 1305, 1311 (10th Cir. 1999) (quotations omitted), and a penalty that "rais[es] money to help defray an agency's regulatory expenses," *id.*, or serves "punitive purposes," *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 134 (4th Cir. 2000). *See also Hoeper v. Tax Comm'n of Wis.*, 284 U.S. 206, 217 (1931) (distinguishing between a "revenue measure[]" and a law "imposing regulatory taxes"); *Hager v. City of W. Peoria*, 84 F.3d 865, 870-71 (7th Cir. 1996) (analyzing whether the TIA barred a challenge to a permit fee, and stating that "[r]ather than a question solely of where the money goes, the issue is *why* the money is taken"); *Robertson v. United States*, 582 F.2d 1126, 1128 (7th Cir. 1978) (distinguishing between "regulatory taxes" and "revenue-raising taxes").

constituted a "tax" under the AIA, an issue that this court seemed to doubt in *Hobby Lobby*, it was a "more general use of coercive power," *Wells*, 510 F.2d at 77, and fell outside the bounds of the AIA.

Here, DMA challenges notice and reporting requirements in Colorado's sales and use tax statutory scheme. These requirements are not a coercive use of power or punitive in nature—they are the state's chosen means of enforcing use tax collection in the first instance. And the state's use tax is indisputably a "tax" under the TIA. The revenue-generating, non-punitive purpose of the notice and reporting obligations places them squarely within the TIA's protection.

* * *

DMA's action seeks to restrain the collection of sales and use taxes in Colorado. The state's notice and reporting obligations, while not taxes themselves, were enacted with the sole purpose of increasing use tax collection. Indeed, the obligations for non-collecting retailers are a substitute for requiring these same retailers to collect sales and use taxes at the point of sale, an approach the Colorado legislature deemed foreclosed by the Supreme Court's decision in *Quill*. Having determined that DMA's action falls within the TIA's prohibition on federal lawsuits that would "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law," 28 U.S.C. § 1341, we proceed to the statute's second element.

2. **Does DMA have a plain, speedy, and efficient remedy in Colorado?**

For the TIA to apply, DMA must also have a "plain, speedy and efficient remedy

. . . in the courts of [Colorado]." 28 U.S.C. § 1341. This part of the TIA requires that Colorado law offer a "full hearing and judicial determination" on its claims. *See Rosewell*, 450 U.S. at 514 (quotations omitted). We must be convinced that Colorado law provides DMA with sufficient process to challenge the notice and reporting requirements. *See Hill*, 478 F.3d at 1253-54.

As previously discussed, Congress intended for the TIA to impose a "broad jurisdictional barrier" that "limit[s] drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Farm Credit Servs.*, 520 U.S. at 825; *see also Grace Brethren Church*, 457 U.S. at 413. The TIA's "plain, speedy and efficient remedy" provision is therefore interpreted "narrowly" to "be faithful to [this] congressional intent." *Id.* Our narrow inquiry asks only whether the "state-court remedy . . . meets certain minimal *procedural* criteria." *Rosewell*, 450 U.S. at 512; *see also Colonial Pipeline Co. v. Morgan*, 474 F.3d 211, 218 (6th Cir. 2007) ("The plain, speedy and efficient remedy contemplated by [the Tax Injunction Act] merely requires that the state provide certain minimal procedural protections against illegal tax collection." (quotations omitted)). The TIA does not require that the state provide the *best* or *speediest* remedy. *See Rosewell*, 450 U.S. at 520; *Alnoa G. Corp. v. City of Houston, Tex.*, 563 F.2d 769, 772 (5th Cir. 1977). And "the likelihood of [a] plaintiff's success in the state court is not a factor . . . when determining whether the jurisdictional prohibition of [the TIA] applies." *Cities Serv. Gas Co. v. Okla. Tax Comm'n*, 656 F.2d 584, 586 (10th Cir. 1981).

DMA does not challenge the process available to it in Colorado. Colorado state courts can and do grant relief in cases challenging the constitutionality of tax measures. *See Riverton Produce Co. v. State*, 871 P.2d 1213, 1230 (Colo. 1994) (en banc). Further, Colorado courts have considered Commerce Clause challenges involving taxes. *See Gen. Motors Corp. v. City & Cnty. of Denver*, 990 P.2d 59, 73 (Colo. 1999) (en banc); *People v. Boles*, 280 P.3d 55, 62-63 (Colo. App. 2011). Circuit courts have routinely said that such available process in state court satisfies the TIA's "plain, speedy and efficient remedy" element. *See, e.g.*, *Washington v. Linebarger, Goggan, Blair, Pena & Sampson, LLP*, 338 F.3d 442, 444-45 (5th Cir. 2003) (availability of a state tax protest provision "or a state declaratory action" was an adequate remedy); *Folio v. City of Clarksburg, W. Va.*, 134 F.3d 1211, 1215 (4th Cir. 1998) (declaratory relief available in state court); *Smith v. Travis Cnty. Educ. Dist.*, 968 F.2d 453, 456 (5th Cir. 1992) (remedy available in state court); *Burris v. City of Little Rock*, 941 F.2d 717, 721 (8th Cir. 1991) ("[Plaintiffs] could also have obtained a declaratory judgment under Ark.Code Ann. § 16-111-103. Federal constitutional claims may, of course, be raised in state court."); *Long Island Lighting Co. v. Town of Brookhaven*, 889 F.2d 428, 431 (2d Cir. 1989) (declaratory judgment available under New York law); *Ashton v. Cory*, 780 F.2d 816, 819-20 (9th Cir. 1986) (plaintiff had no plain state refund remedy, but had already "assert[ed] its claims in the California courts," which "afford[ed] the required full hearing and judicial determination of its preemption claims"); *Sipe v. Amerada Hess Corp.*, 689 F.2d 396, 405 (3d Cir. 1982) (in personam proceeding could be maintained in state court).

We are hesitant, however, to stop our analysis there. The Supreme Court in *Hibbs* suggested that the TIA does not refer to general process available in state court. The Court said that a "plain, speedy and efficient remedy" under 28 U.S.C. § 1341 is "not one designed for the universe of plaintiffs who sue the State. Rather, it [is] a remedy tailormade for taxpayers." 542 U.S. at 107. It then cited to decisions in which taxpayers were allowed to protest taxes in state court after first seeking a refund under state administrative law. Although the *Hibbs* Court was not deciding any issue specifically dealing with the "plain, speedy and efficient remedy" language of the TIA, its brief discussion suggests that the statutory language may contemplate something more than the general availability of a remedy to "the universe of plaintiffs who sue the State."[8]

As discussed earlier, in *Hill v. Kemp*, this court determined that the TIA may bar third-party non-taxpayer lawsuits, despite the *Hibbs* Court's discussion of taxpayer

[8] Despite this language in *Hibbs*, the Seventh Circuit, sitting en banc, recently determined that the TIA applied where a plain, speedy, and efficient remedy was available generally in state court. In *Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc.*, 651 F.3d 722 (7th Cir. 2011) (Posner, J.) (en banc), casinos challenged in federal court Illinois statutes requiring them to deposit a portion of their revenues in a state fund for racetracks. *Id.* at 725. The casinos, alleging a RICO violation, asked the federal court to impose "a constructive trust in their favor on the money received by the racetracks." *Id.* After determining that the action "would thwart the tax as surely as an injunction against its collection," *id.* at 726, the court briefly addressed the TIA's "plain, speedy and efficient remedy" language. It determined that there was such a remedy because "the casinos [could] ask an Illinois state court to impose a constructive trust on the tax receipts." *Id.* at 734. In other words, the casinos could do in state court what they sought to do in federal court.

This post-*Hibbs* opinion supports applying the TIA here, where state court process is available to DMA.

lawsuits. 478 F.3d at 1249 ("Nothing in the language of the TIA indicates that our jurisdiction to hear challenges to state taxes can be turned like a spigot, off when brought by taxpayers challenging their own liabilities and on when brought by third parties challenging the liabilities of others."). In *Hill*, the plaintiffs had a "plain, speedy and efficient" remedy in state court because Oklahoma tax statutes provided "a general right to protest taxes before the Tax Commission," as well as a right of action to remedy grievances for any state tax law that is contrary to federal law or the Constitution. *Id.* at 1253-54 (citing 68 Okla. Stat. §§ 201 et seq. and *id.* § 226). Oklahoma law also specifically allowed for declaratory relief against unlawful taxes. *Id.* at 1254 (citing 12 Okla. Stat. § 1397).

Thus, in *Hill*, the plaintiffs could seek a remedy under specific state tax laws. This was consistent with *Hibbs* in that these remedies were not available to the universe of plaintiffs suing the state. Accordingly, we address whether Colorado's tax laws similarly provide a more specific remedy to DMA: How can DMA or the remote retailers it represents challenge Colorado's statutory scheme outside of filing an action in state court for injunctive or declaratory relief?

DMA complains that Colorado's laws force remote retailers to choose between obeying the notice and reporting requirements and remitting sales tax to the Department. Aplee. Br. at 46-47. Much like a taxpayer who seeks to challenge a state tax but must first pay the tax and seek a refund under state law, a remote retailer could choose to remit sales tax and then seek a refund. Colo. Rev. Stat. § 39-26-703(2.5)(a) allows retailers to

"file *any claim for refund* with the executive director of the department of revenue." (Emphasis added).[9] In pursuing the refund, the retailer could argue that Colorado laws unconstitutionally coerce it to choose between collecting a sales tax and complying with the notice and reporting requirements, the same Commerce Clause argument it brings here. *See* Aplee. Br. at 46-47 ("[T]he State of Colorado seeks to *compel* retailers who have declined to collect Colorado sales tax voluntarily[] to give[]up their constitutional rights not to collect such taxes. Although the [Department] argues that the retailer's decision in the face of such coercion is a 'choice,' the Constitution precludes such oppressive and discriminatory measures against interstate commerce." (citation omitted)). The director then would "promptly examine such claim and . . . make a refund or allow a credit to any [retailer] who establishes that such [retailer] overpaid the tax due." Colo. Rev. Stat. § 39-26-703(2.5)(a). If the retailer is "aggrieved at the final decision," it may seek review in the state district courts. *Id.* § 39-26-703(4).

Another remedy for a remote retailer is to challenge any penalties it incurs for failing to comply with the notice and reporting obligations. *See, e.g.*, *id.* § 39-21-

[9] If a retailer chooses to pay sales tax rather than comply with the notice and reporting requirement, the retailer is "liable and responsible for the payment" of sales tax of 2.9 percent, payable monthly by submitting a return to the Department. Colo. Rev. Stat. § 39-26-105(1)(a). If the retailer does not collect the tax from purchasers, but still pays the 2.9 percent as required by law, the refund claim would be on the retailer's behalf. *See id.* § 39-26-703(2.5)(a) (executive director is to determine whether the *vendor* overpaid tax). If the retailer collects sales tax from purchasers and remits it to the Department, it can bring a refund claim on behalf of the purchasers if the retailer complies with certain requirements. *Id.* § 39-26-703(2.5)(b).

112(3.5)(c)(II), (d)(III)(A)-(B) (providing for penalties). Under Colo. Rev. Stat § 39-21-103, a taxpayer may dispute a tax owed to the Department after receiving a notice of deficiency and may request a hearing. Although this provision discusses tax deficiencies, it also contemplates disputes involving *penalties* owed to the Department. *See id.* § 39-21-103(8)(c). This provision also contemplates the taxpayer and the executive director agreeing that "a question of law arising under the United States or Colorado constitutions" is implicated in the dispute, bypassing a hearing, and going "directly to the district court." *Id.* § 39-21-103(4.5).[10]

We are satisfied that Colorado provides avenues for remote retailers to challenge the scheme allegedly forcing them to choose between collecting sales tax and complying with the notice and reporting requirements. Colorado's administrative remedies provide for hearings and appeals to state court, as well as ultimate review in the United States Supreme Court. *See Rosewell*, 450 U.S. at 514 (a plain, speedy, and efficient remedy exists if a "full hearing and judicial determination" is available and the party "may raise any and all constitutional objections to the tax"); *see also Colonial Pipeline*, 474 F.3d at 218 ("State procedures that call for an appeal to a state court from an administrative decision meet these minimal criteria." (quotations omitted)). Whether DMA or a remote retailer it represents files a similar lawsuit in state court seeking injunctive and

[10] This provision applies to "taxpayers." Colorado law defines "taxpayer" as "a person against whom a deficiency is being asserted, whether or not he has paid any of the tax in issue prior thereto." Colo. Rev. Stat. § 39-21-101(4). A "person" includes business entities such as retailers. *Id.* § 39-21-101(3).

declaratory relief, or whether it follows Colorado's administrative tax procedures, a plain, speedy, and efficient remedy is available in Colorado.

III. **CONCLUSION**

The TIA divested the district court of jurisdiction over DMA's Commerce Clause claims, and we therefore have no jurisdiction to reach the merits of this appeal.[11] We remand for the district court to dismiss DMA's Commerce Clause claims for lack of jurisdiction, dissolve the permanent injunction entered against the Department, and take further appropriate action consistent with this opinion.

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[11] Although we remand to dismiss DMA's claims pursuant to the TIA, we note that the doctrine of comity also militates in favor of dismissal. *See Brooks*, 801 F.2d at 1240-41 ("Though we find that section 1341 deprived the federal district courts of subject-matter jurisdiction in this action, we conclude that the doctrine of comity also provides a basis for arriving at the same conclusion."). Even in cases where the TIA may not apply, "principles of federal equity may nevertheless counsel the withholding of relief." *Rosewell*, 450 U.S. at 525-26 n. 33 (1981). As the Supreme Court stated in *Levin v. Commerce Energy, Inc.*, 130 S. Ct. 2323 (2010), the comity doctrine is "[m]ore embracive than the TIA" and "restrains federal courts from entertaining claims for relief that risk disrupting state tax administration." *Id.* at 2328. This reluctance to interfere with taxation out of deference for state governance can even extend to lawsuits seeking to enjoin state tax benefits to others, where the TIA may not apply. *See id.* at 2332 (clarifying *Hibbs* as relying on the TIA and concluding that comity can extend further to preclude federal jurisdiction).

In *Levin*, the Court discussed three factors that "compel[led] forbearance on the part of federal district courts" with respect to a Commerce Clause and equal protection challenge to Ohio's taxation scheme: (1) the state enjoyed great freedom in tax classifications, as opposed to more suspect classifications; (2) the plaintiffs sought to improve their competitive position; and (3) the state courts were not as constrained in fashioning a remedy. *Id.* at 2336. Similar considerations control here and "demand deference to the state adjudicative process." *Id.*

13-553 AL DEPT. OF REVENUE V. CSX TRANSPORTATION, INC.

DECISION BELOW: 720 F.3d 863

LOWER COURT CASE NUMBER: 12-14611

QUESTION PRESENTED:

Three years ago, this Court granted certiorari in this case and held that a railroad could challenge certain state tax exemptions under the Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. §11501(b)(4). This petition presents a question the Court expressly left open for the courts' consideration on remand. The Eleventh Circuit resolved it in a way that is contrary to the rule Justices Thomas and Ginsburg proposed in their separate opinion, and the circuits are now split 3-2 on this question. The question is as follows:

Whether a State "discriminates against a rail carrier" in violation of 49 U.S.C. §11501(b)(4) when the State generally requires commercial and industrial businesses, including rail carriers, to pay a sales-and-use tax but grants exemptions from the tax to the railroads' competitors.

IN ADDITION TO THE QUESTION PRESENTED BY THE PETITION, THE PARTIES ARE DIRECTED TO BRIEF AND ARGUE THE FOLLOWING QUESTION: " Whether , in resolving a claim of unlawful tax discrimination under 49 U.S.C. §11501(b)(4), a court should consider other aspects of the State's tax scheme rather than focusing solely on the challenged tax provision."

CERT. GRANTED 7/1/2014

[PUBLISH]

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

No. 12-14611

D.C. Docket No. 2:08-cv-00655-AKK

CSX TRANSPORTATION, INC.,

Plaintiff - Appellant,

versus

ALABAMA DEPARTMENT OF REVENUE,
COMMISSIONER, ALABAMA DEPARTMENT OF REVENUE,

Defendants - Appellees.

Appeal from the United States District Court
for the Northern District of Alabama

(July 1, 2013)

Before WILSON and COX, Circuit Judges, and BOWEN,[*] District Judge.

WILSON, Circuit Judge:

The State of Alabama (State) imposes a 4% sales tax on the gross receipts of retail businesses, and a 4% use tax on the storage, use, or consumption of tangible personal property. *See* Ala. Code §§ 40-23-2(1), -61(a).[1] Appellant CSX Transportation, Inc. (CSX), an interstate rail carrier, pays the 4% sales tax whenever it purchases diesel fuel in the State. CSX's main competitors in the State—interstate motor and water carriers—do not. In this appeal, we must decide whether exempting CSX's main competitors from the State's sales tax is discriminatory as to rail carriers in violation of the Railroad Revitalization and Regulation Reform Act of 1976 (4-R Act), 49 U.S.C. § 11501(b)(4). We conclude that the sales tax is indeed discriminatory and that the State has not offered a "sufficient justification" for exempting CSX's competitors. *See CSX Transp., Inc. v. Ala. Dep't of Revenue* (*CSX II*), —— U.S. ——, 131 S. Ct. 1101, 1109 n.8 (2011) ("Whether the railroad will prevail . . . depends on whether the State offers a sufficient justification for declining to provide the exemption at issue to rail carriers."). Accordingly, we reverse.

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[*] Honorable Dudley H. Bowen, Jr., United States District Judge for the Southern District of Georgia, sitting by designation.

[1] For purposes of clarity, both taxes will be referred to as the "sales tax."

I. BACKGROUND

Rail carriers, motor carriers, and water carriers all compete for the shipment of freight in interstate commerce. Although all three purchase diesel fuel toward that end, the State taxes each competitor's purchases differently: water carriers pay no tax whatsoever on their diesel fuel purchases, *see* Ala. Code § 40-23-4(a)(10); rail carriers pay the State's 4% sales tax; and motor carriers pay an excise tax of 19¢ per gallon, *see* Alabama Terminal Excise Tax Act (fuel excise tax), 2011 Ala. Act 565 (effective October 2012).[2]

The State distributes the revenue from the fuel excise tax as follows: for every gallon sold, 13¢ goes to the Alabama Department of Transportation for the construction, repair, maintenance, and operation of public roads and bridges, and the payment of principal and interest on highway bonds; the remaining 6¢ goes to cities and counties for the construction and maintenance of roads and bridges, and to the Department of Transportation for general highway purposes. Revenue from the sales tax, on the other hand, goes toward a general revenue fund. *See* Ala. Code §§ 40-23-35, 40-23-85.

[2] During the majority of this litigation, the State codified its fuel excise tax at section 40-17-2 of the Alabama Code. In October 2012, the State repealed that section and modified its motor fuel tax scheme. *See* Alabama Terminal Excise Tax Act, 2011 Ala. Act 565 (effective October 2012). The new statute changes the timing of the tax's imposition, but the amount of the excise tax (19¢/gallon of diesel fuel) remains the same, and it still exempts motor carriers from paying the State's sales tax on diesel-fuel purchases. For purposes of clarity, both taxes will be referred to as the "fuel excise tax."

It is axiomatic that a state has broad discretion in the exercise of its taxing power. *See Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S. Ct. 1001, 1003 (1973); *Weissinger v. White*, 733 F.2d 802, 805 (11th Cir. 1984). That discretion will be reined in, however, where it offends a "specific federal right." *Lehnhausen*, 410 U.S. at 359, 93 S. Ct. at 1003. At issue here are the federal rights Congress has afforded rail carriers pursuant to the 4-R Act. That Act provides that a state may not:

> (1) Assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
>
> (2) Levy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection.
>
> (3) Levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
>
> (4) *Impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Board under this part.*

49 U.S.C. § 11501(b) (emphasis added).

Enacted to "restore the financial stability of the railway system of the United States," the 4-R Act "target[s] state and local taxation schemes that discriminate against rail carriers." *CSX II*, 131 S. Ct. at 1105 (internal quotation marks

omitted). CSX contends that the State's sales tax discriminates against it in violation of § 11501(b)(4) because CSX's main competitors do not pay the sales tax when they purchase diesel fuel, giving them a competitive advantage over CSX.

CSX filed this lawsuit against Alabama's Department of Revenue and its Commissioner in 2008. After the district court dismissed the complaint, we affirmed the dismissal based on our precedent in *Norfolk Southern Railroad Co. v. Alabama Department of Revenue*, 550 F.3d 1306, 1316 (11th Cir. 2008), which established the rule that a railroad could not challenge its competitors' exemptions from a sales tax as discriminatory under the 4-R Act. *See CSX Transp., Inc. v. Ala. Dep't of Revenue* (*CSX I*), 350 F. App'x 318, 319 (11th Cir. 2009) (per curiam). CSX appealed, and the Supreme Court granted certiorari, overruled our decision in *Norfolk*, and held that "CSX may challenge Alabama's sales and use taxes as tax[es] that discriminat[e] against rail carrier[s] under § 11501(b)(4)." *CSX II*, 131 S. Ct. at 1114 (alterations in original) (internal quotation marks omitted). The Court appeared to impliedly assume that the State's exemptions for CSX's competitors would be discriminatory unless "the State offers a sufficient justification for declining to provide the exemption at issue to rail carriers." *Id.* at 1109 n.8.

After we remanded the case back to the district court, the court conducted a bench trial and issued an order holding that the State's sales tax did not discriminate against CSX in violation of § 11501(b)(4). *See CSX Transp. Inc. v. Ala. Dep't of Revenue* (*CSX III*), 892 F. Supp. 2d 1300, 1317 (N.D. Ala. 2012). The district court reasoned that because the State's motor carriers paid a roughly equivalent amount in taxes pursuant to the State's fuel excise tax, the motor carriers' exemption from the sales tax was not discriminatory. *Id.* at 1313 (finding that "the tax rate imposed per gallon of diesel fuel for rail carriers and motor carriers is essentially the same"). As to the water carriers, the district court held that CSX had offered "no evidence regarding the purported discriminatory effect as it relates to water carriers." *Id.* at 1316. The district court dismissed the matter, and this appeal followed.

II. ANALYSIS

We review the district court's application of the 4-R Act de novo, *see Alphamed, Inc. v. B. Braun Med., Inc.*, 367 F.3d 1280, 1285 (11th Cir. 2004), taking special heed of the guidance provided by the Supreme Court in *CSX II*. "'Discrimination,'" the Court wrote, "'is the failure to treat all persons equally when no reasonable distinction can be found between those favored and those not favored.'" *CSX II*, 131 S. Ct. at 1108 (quoting Black's Law Dictionary 534 (9th ed. 2009)). For example, "[t]o charge one group of taxpayers a 2% rate and

another group a 4% rate, if the groups are the same in all relevant respects, is to discriminate against the latter." *Id.* A tax exemption is analogous because the "State takes the favored group's rate down to 0%." *Id.* Therefore, *CSX II*'s holding suggests that a tax exemption disfavoring a rail carrier creates a rebuttable presumption of discrimination, unless the State can "offer[] a sufficient justification for declining to provide the exemption at issue to rail carriers." *Id.* at 1110 n.8.

A. Comparison Class

Before we address whether the exemption at issue is discriminatory, there remains a first-order question that the Court left untouched and has yet to be answered in this circuit: against what do we compare the railroads? The matter is one of scope, as any model of discrimination requires a fixed set of participants. If we compare CSX to all of the State's taxpayers, it is no worse off because most taxpayers pay the sales tax when they purchase diesel fuel. On the other hand, if we compare CSX to motor and water carriers, questions of favorable treatment arise because they do not pay the sales tax. Among our sister circuits there are essentially two camps: the functional approach and the competitive approach.

We acknowledge that the question of the proper comparison class has not been the central inquiry of this appeal. In the proceedings below, the district court and the parties adopted the competitive approach, assuming that CSX must be

compared with only motor and water carriers. Although we ultimately conclude that the competitive approach is appropriate in this circumstance, we are obliged to say a few words concerning the diversity of opinions on this matter.

Employing the functional approach, the Seventh and Ninth Circuits have compared the rail carriers to other "commercial and industrial" taxpayers based on § 11501(b)(4)'s three preceding subsections, which all contain the phrase "commercial and industrial." *See Kansas City S. Ry. Co. v. Koeller*, 653 F.3d 496, 508 (7th Cir.), *cert. denied*, 132 S. Ct. 855 (2011); *Atchison, Topeka & Santa Fe Ry. Co. v. Arizona*, 78 F.3d 438, 441 (9th Cir. 1999). For example, in *Koeller* the Seventh Circuit considered whether an Illinois subdivision's method of calculating taxes discriminated against railroads in violation of § 11501(b)(4). Seven hundred taxpayers comprised the tax base of the subdivision: eight of the 700 taxpayers were railroads, pipelines, and utilities (RPU properties). *Koeller*, 653 F.3d at 500. Of the remaining 692 taxpayers, 14 conducted commercial and industrial operations, several were residents, and the vast majority used the land for agricultural purposes. *Id.* After severe floods and an increase in the price of diesel fuel sent the subdivision into a budgetary crisis, its commissioners increased the annual maintenance assessment—which for all intents and purposes was a "tax." *Id.* Although the majority of the subdivision's landowners saw modest hikes in their annual assessments, the RPU properties saw "astronomical increase[s]." *Id.*

at 502. Norfolk Southern's assessment, for instance, jumped a whopping 8,300% in one year, from $1,126 to $93,920. *Id.*

Before reaching the question of whether the tax was discriminatory, the Seventh Circuit acknowledged the different comparison-class options at its disposal. The court opted for the functional approach, in part because of "the need to read subsection (b)(4) in light of the approach taken in the first three subsections of the 4-R Act, which all directly or indirectly look to other commercial and industrial property." *Id.* at 509 (internal quotation marks omitted). Yet the Seventh Circuit also recognized that "there are *no* competitors of the railroads—motor carriers, air carriers, barges, [or] Great Lakes ships—that [the subdivision] is trying to tax." *Id.* (alteration in original) (emphasis in original) (internal quotation marks omitted). Therefore, opting for the competitive approach in *Koeller* would have yielded the bizarre result that a tax singularly raising a rail carrier's tax rate by 4,800% was not discriminatory. With that in mind, the court compared the rail carriers with "the 14 additional commercial and industrial taxpayers" who did not suffer such a dramatic increase in their tax obligations, and held that the tax was discriminatory. *Id.* at 509–10.

Contrarily, the Eighth Circuit has endorsed the narrower "competitive approach" model, at least when considering a state's sales tax. *See Union Pac. R.R. Co. v. Minn. Dep't of Revenue*, 507 F.3d 693, 695 (8th Cir. 2007); *Burlington*

N., Santa Fe Ry. Co. v. Lohman, 193 F.3d 984, 986 (8th Cir. 1999) (choosing the competitive model, but acknowledging that "the comparison class should be appropriate *to the type of tax and discrimination* challenged in a particular case" (emphasis added)). In *Lohman*, the Eighth Circuit addressed a scenario identical to the one before us: whether an exemption to Missouri's sales tax caused the sales tax to violate § 11501(b)(4). *See Lohman*, 193 F.3d at 984. In that case too, motor carriers paid a fuel excise tax rather than a sales tax. *Id.* at 985. The court ultimately held that "the proper comparison class for Missouri sales and use taxes is the competitive mode." *Id.* at 986. Paying homage to the 4-R Act's broad purpose of restoring the railroads' financial stability, the court emphasized that "[s]tability cannot be restored without making the railroads competitive." *Id.* Furthermore, the court continued, if Congress "had wanted [§ 11501(b)(4)] to have the same comparison class as the property tax subsections, and none other, it would have written it that way." *Id.*; *see also Atchison*, 78 F.3d at 445 (Nielsen, J., dissenting) ("If Congress wanted [§ 11501(b)(4)] to share the same broad comparison class as the three preceding subsections, and none other, it would have said so. It did not."). This result made sense, the court reasoned, because a broad comparison class in that instance would have put the railroads "at a competitive disadvantage." *Lohman*, 193 F.3d at 986.

We have carefully studied the different approaches available to us, and we conclude that in light of the 4-R Act's purpose of ensuring "financial stability" for rail carriers, the competitive model best serves that goal in the context of a state's sales tax on diesel fuel.[3] Moreover, CSX and the State stipulated, and the district court agreed, that the proper comparison class for this case was CSX's competitors.[4] Having determined that the appropriate comparison class is CSX's competitors, we turn to the question of whether the sales tax is discriminatory.

B. Discrimination

As noted earlier, the Supreme Court held that tax exemptions can be discriminatory under the 4-R Act. *CSX II*, 131 S. Ct. at 1114. Given that we have opted for a competitive model in this case, and CSX's competitors do not pay the State's sales tax, we hold that CSX has established a prima facie case of

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[3] We therefore decline to adopt Justices Thomas's dissent in *CSX II*, which would have held that the appropriate comparison class in all 4-R Act discrimination cases is all commercial and industrial taxpayers. *See CSX* II, 131 S. Ct. at 1115 (Thomas, J., dissenting) ("I would hold that, to violate § 11501(b)(4), a tax exemption scheme must target or single out railroads by comparison to general commercial and industrial taxpayers."). While this comparison class might be appropriate in certain situations, like *Koeller*, it fails to address discriminatory taxes that place rail carriers at a significant disadvantage vis-à-vis their competitors.

[4] Our approach creates tension with the Seventh Circuit's holding in *Koeller* only to the extent that *Koeller* established a bright-line rule for § 11501(b)(4) cases. *See Koeller*, 653 F.3d at 509 ("Given our preference for clarity, however, rather than an ill-defined 'all the circumstances' type of test, we are content for now to endorse reference to other commercial and industrial users."). While we recognize the virtues of bright-line rules, § 11501(b)(4) is a broad statute, designed to strike down all discriminatory taxes that place rail carriers at a competitive disadvantage—and Congress "specifically chose to omit any reference to a comparison class in subsection [(b)(4)]." *Atchison*, 78 F.3d at 445 (Nielsen, J., dissenting). Thus, while a malleable approach might not lend itself to the most efficient application, the language and purpose of § 11501(b)(4) require that "the comparison class should be appropriate to the type of tax and discrimination challenged in a particular case." *Lohman*, 193 F.3d at 986.

discrimination. Quite simply, the sales tax overburdens the rail carriers because its competitors do not pay it. It therefore becomes the State's burden to justify its discriminatory tax. *See id.* at 1110 n.8.

The State devotes the majority of its brief to defending the motor carriers' exemption to the sales tax on the ground that the motor carriers pay a roughly equivalent amount of taxes under the fuel excise tax. This argument misses the mark. Rather than framing the tax in question at its highest level of abstraction as "all the taxes paid on diesel-fuel purchases," we agree with the Eighth Circuit that "we look only at the sales and use tax with respect to fuel to see if discrimination has occurred." *Union Pacific*, 507 F.3d at 695 (internal quotation marks omitted). We are persuaded that even though in some years—depending on the price of diesel fuel—the State's taxing arrangement might yield a fair result, "the actual fairness of those arrangements is too difficult and expensive to evaluate." *Lohman*, 193 F.3d at 986 (quoting *Trailer Train Co. v. State Tax Comm'n*, 929 F.3d 1300, 1303 (8th Cir. 1991)).

This construction of the 4-R Act finds support in the Act's text. Section 11501(b)(4) prohibits the states from "impos[ing] another tax that discriminates against a rail carrier," but the statute hardly "suggests that an individually discriminatory tax should be assessed for fairness against the entire tax structure of the state." *Kansas City S. Ry. v. McNamara*, 817 F.2d 368, 377 (5th Cir. 1987). If

the 4-R Act required us to examine the tax regime for an entire commodity, it would have said so rather than speaking in the singular about "another tax." Like the Eighth Circuit in *Lohman*, we find the Fifth Circuit's well-reasoned opinion in *McNamara* to speak directly on this issue.

In *McNamara*, the Fifth Circuit struck down a Louisiana tax imposed on transportation and communication utilities, which included rail carriers. *Id.* at 370. Using a commercial and industrial taxpayer comparison class, the Fifth Circuit held that the tax was discriminatory, and that Louisiana could not justify it based on the fact that other commercial and industrial taxpayers paid a roughly equivalent amount in sales and use taxes. *Id.* at 377. Refusing to consider the sales tax, the Fifth Circuit held that "[d]etermining the intrinsic economic fairness of a tax system to a particular taxpayer is a paradigm of the kind of polycentric problem for which courts are ill-suited." *Id.*

McNamara provided the rationale for the Eighth Circuit in *Lohman* and its progeny to hold that courts should not evaluate a state's sales tax against other taxes in the state's code. *See Lohman*, 193 F.3d at 986. Here, the district court below rejected the Eighth Circuit's reliance on *McNamara* because *McNamara* employed the functional approach rather than the narrower competitive approach, and when the comparison class is thereby "drastically reduced" it does not "impose substantial theoretical and practical difficulties on a court." *CSX III*, 892 F. Supp.

2d at 1311. Because the comparison class has been narrowed, the dissent assures us, federal courts would not engage in "such a searching, time-consuming, expensive, and impracticable analysis." Dissenting Op. at 6. We disagree.

Although the class of taxpayers might have been narrower had we opted for the functional approach, the "theoretical difficult[ies]" that concerned the *McNamara* court would remain. *McNamara*, 817 F.2d at 377. We would still be forced to decide whether a state's fixed-percentage sales tax for one market participant is roughly equivalent to an *ad valorem* excise tax for another market participant. In addition, the authoritative value of that assessment would ebb and flow with every oscillation in diesel fuel's market value—we would operate for some months, perhaps even years, under the fiction that the two taxes are equivalent.[5] *Id.* ("Furthermore, there is no reason in principle why the railroads could not sue for such a judicial assessment *each year* (or for each tax bill) because the dynamic nature of any state's economy will alter the relative benefits and burdens of its tax system from moment to moment." (emphasis in original)). And if the price of diesel fuel causes rail carriers to bear a significantly larger tax burden than its competitors, at what point must we reverse course and hold that the

[5] The dissent also points out that under today's holding, "the sales and use taxes would discriminate against a rail carrier even if its competitors paid four times as much tax as the rail carrier for the same commodity." Dissenting Op. at 7–8. But if we were to adopt the dissent's approach and accept the State's justification for its discriminatory tax—that motor carriers pay some other commodity tax, that is sometimes equivalent—the reverse would also be true. That is to say, the sales and use tax exemption *would not* discriminate against a rail carrier even if its competitors paid four times *less* in tax as the rail carrier for the same commodity.

sales tax is discriminatory? After one year of inequity? Three?[6] To adjust the comparison class makes little difference, and it behooves us to bear in mind the words of the Supreme Court:

> [C]ourts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. The complexities of factual economic proof always present a certain potential for error, and courts have little familiarity with the process of evaluating the relative economic burden of taxes.

Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue, 460 U.S. 575, 589–90, 103 S. Ct. 1365, 1374 (1983) (footnote omitted).

We therefore decline to undertake the Sisyphean burden of evaluating the fairness of the State's overall tax structure in order to determine whether a single tax exemption causes a state's sales tax to be discriminatory. This case, then, becomes much simpler than it would appear at first blush. Rail carriers pay the State's sales tax—motor and water carriers do not. It is not a sufficient justification for the State to counter that its tax code will ultimately level the playing field.

Even if it were true that the exemptions at issue were not enacted to unfavorably target rail carriers, our decision would be the same because discrimination under § 11501(b)(4) "can be shown even if there is no direct

[6] This is to say nothing of the added value that the motor carriers receive from being able to accurately forecast their year-to-year tax burden by virtue of being subject to a fixed excise tax rather than a variable *ad valorem* tax.

evidence of targeting," as long as the tax imposes a proportionately heavier burden on rail carriers. *Koeller*, 653 F.3d at 510. Here, the rail carriers' main competitors have received favorable treatment: tax exemptions. In response, the State offers no "reasonable distinctions between the favored and the disfavored"; therefore it has failed to carry the burden set forth by the Supreme Court in *CSX II*. *Id.* In *CSX II*, the Supreme Court queried the State: "Can you justify why motor and water carriers are taxed differently than rail carriers?" The State responds: "Motor and water carriers are taxed differently because they are taxed differently." But the Supreme Court demanded a justification from the State, not a Zen proverb. Section 11501(b)(4) does not allow us to sit idly by and take the State at its word that, in the long run, its tax code will burden CSX no more than its competitors. Moreover, no one can seriously dispute that the water carriers, who pay not a cent of tax on diesel fuel, are the beneficiaries of a discriminatory tax regime.

III. CONCLUSION

In short, after establishing a comparison class of competitors and showing that its competitors did not pay the sales tax on diesel fuel purchases, CSX made a prima facie showing of discrimination under § 11501(b)(4). The burden shifted to the State to provide a "sufficient justification" for the exemptions. It did not. We reverse the district court, hold that the State's sales tax violates the 4-R Act, and

remand to the district court with instructions to enter declaratory and injunctive relief in favor of CSX consistent with this opinion.

REVERSED AND REMANDED.

COX, Circuit Judge, dissenting:

I dissent. Though I agree that the appropriate comparison class consists of the stipulated competitors, I do not agree that a tax exemption for interstate motor carriers discriminates against interstate rail carriers when motor carriers in fact carry a similar or heavier tax burden for purchase of the same commodity. As for the tax exemption for interstate water carriers, I conclude that the district court improperly placed the burden on CSX to provide evidence of the exemption's discriminatory effect. I would affirm the district court's ruling to the extent that it finds no violation of the 4-R Act with respect to the motor carriers' exemption but remand for reconsideration as to interstate water carriers.

The Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) prohibits a state taxing authority from taking certain actions that place unfair burdens on railroads. The statute's first three subsections bar a state from making unfair assessments on railroad property, collecting a tax on such unfair assessments, and collecting an *ad valorem* property tax at a rate greater than that imposed on other "commercial and industrial property," 49 U.S.C. § 11501(b)(1)–(3).[1] At issue in this case is § 11501(b)(4), which prohibits a state and its

[1] Section 11501(b)(1)–(3) reads:

> (b) The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them:

subdivisions from "[i]mpos[ing] another tax that discriminates against a rail carrier." *Id.* § 11501(b)(4).

We use a two-step inquiry to evaluate a claim of discrimination in violation of § 11501(b)(4). *See CSX Transp., Inc. v. Ala. Dep't of Revenue*, 131 S. Ct. 1101, 1109 n.8 (2011) (*CSX II*). The plaintiff railroad (CSX here) has the initial burden to establish a prima facie case of discriminatory tax treatment. If the plaintiff does so, the burden shifts to the defendant taxing authority (the State here) to establish that the differential tax treatment is justified and does not discriminate against the railroad. *Id.* ("Whether the railroad will prevail—that is, whether it can prove the alleged discrimination—depends on whether the State offers a sufficient justification for declining to provide the exemption at issue to rail carriers."). If the defendant cannot meet its burden, the tax treatment violates § 11501(b)(4).

The parties in this case have agreed that CSX's competitors are interstate motor carriers ("on-highway motor carriers of property in interstate commerce") and interstate water carriers ("carriers of property in interstate commerce by ships,

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> (1) Assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
> (2) Levy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection.
> (3) Levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.

barges and other vessels"). (Dkt. 63 ¶ 10, at 3.) I proceed through the two-step analysis first with respect to motor carriers and then with respect to water carriers.

A. Motor Carriers

Like the majority, I have no doubt that CSX has established a prima facie § 11501(b)(4) violation by showing that the sales and use taxes apply to rail carriers but exempt motor carriers. (Op. at 11–12.) Where I disagree is in the second step of the analysis: whether the State has justified the differential treatment.

The State explains the exemption by pointing out that motor carriers must pay the 19¢ state excise tax per gallon of fuel they purchase. Rail carriers do not pay this tax. According to the State's argument, the fact that rail carriers are not subject to the excise tax justifies the differential treatment in the sales and use taxes, and the sales and use taxes do not discriminate against rail carriers.

The district court agreed with the State. *CSX Transp., Inc. v. Ala. Dep't of Revenue*, 892 F. Supp. 2d 1300, 1312–14 (N.D. Ala. 2012) (*CSX III*). The court compared the state sales and use taxes (measured in terms of what rail carriers paid per gallon of fuel, including the 4% tax) to the state motor-fuel excise tax (measured in terms of what motor carriers paid per gallon, including the 19¢-per-gallon tax) assessed from January 2007 to December 2009. *Id.* at 1313. The court found that "motor carriers actually pa[id] a higher" state tax. *Id.* Even adding to

the comparison the additional sales and use taxes imposed on rail carriers by counties and cities in Alabama, motor carriers and rail carriers paid "substantially similar" taxes during the period in question. *Id.*[2] And that comparison failed to incorporate the motor-fuel excise taxes assessed by counties and cities on motor carriers, which ranged from 1¢ to 6¢ added to the state excise tax imposed on motor carriers. *Id.* In sum, the district court found, the taxes paid by rail carriers and motor carriers for fuel was "essentially the same." *Id.* Because its findings are not challenged on appeal, I accept them as accurate.

None of these findings are relevant, CSX argues, because the State cannot justify differential treatment by showing that the entities that are exempt from sales and use taxes are subjected to a separate tax not imposed on rail carriers. The majority agrees with CSX's position. It refuses to compare the two taxes, regardless of the numbers the taxing arrangement yields. (*See* Op. at 12.) But based on my reading of the Supreme Court's opinion in *CSX II* and case law in other circuits, I find this position both unsupported and contrary to Congress's intent.

CSX's argument and the majority opinion follow the approach taken by the Eighth Circuit in *Union Pacific Railroad Co. v. Minnesota Department of Revenue*,

[2] I assume that sales and use taxes imposed by cities and counties are at issue in this case. Given that CSX named no city or county as a defendant, this assumption may not be true; I hesitate to agree that a city or county can be enjoined from imposing a tax when it has not been named as a party. But even if they can, my conclusion remains the same.

507 F.3d 693 (8th Cir. 2007). There, the Eighth Circuit considered Minnesota's generally applicable sales tax on railroad fuel that exempted two primary competitors (motor carriers and air carriers) because they paid a separate excise tax, *see id.* at 694—a scenario nearly identical to the one confronting us here. Based on its earlier opinion in *Burlington Northern, Santa Fe Railway Co. v. Lohman*, 193 F.3d 984 (8th Cir. 1999), the Eighth Circuit refused to consider any other tax as a justification for the facial discrimination. *See Union Pac.*, 507 F.3d at 695 ("[W]e 'look only at the sales and use tax with respect to fuel to see if discrimination has occurred.'" (quoting *Lohman*, 193 F.3d at 986)).

But as the district court recognized, *see CSX III*, 892 F. Supp. 2d at 1310–11, the Eighth Circuit's simplistic approach to evaluating challenges under § 11501(b)(4) incorrectly relies on distinguishable case law. *Lohman*, on which *Union Pacific* rests, refuses to consider other taxes as justification for facially discriminatory tax treatment. 193 F.3d at 986. The *Lohman* court relies on two cases for the proposition that the fairness of this tax scheme is "too difficult and expensive to evaluate," *id.*: the Fifth Circuit's opinion in *Kansas City Southern Railway Co. v. McNamara*, 817 F.2d 368 (5th Cir. 1987), and the Eighth Circuit's own opinion in *Trailer Train Co. v. State Tax Commission*, 929 F.2d 1300 (8th Cir.

1991).[3] But both *McNamara* and *Trailer Train* address a materially distinct fact pattern, and their analyses are unsuitable for this case.

In *McNamara* and *Trailer Train*, the court considered a different kind of tax—a specific tax that "targeted" railroads for differential treatment,[4] rather than a general tax that exempted railroads' competitors. In each case, the court decided that the appropriate comparison class consisted of *all commercial and industrial taxpayers*. In each case, the state argued that the tax did not discriminate against railroads because the state's tax structure, *as a whole*, treated railroads similarly to every other commercial and industrial taxpayer. And in each case, the court refused to entertain such a searching, time-consuming, expensive, and impracticable analysis. *See Trailer Train*, 929 F.2d at 1302–03; *McNamara*, 817 F.2d at 377–78.

Here, we have a much narrower issue. The appropriate comparison class includes the two stipulated competitors—a far more manageable class than one composed of all commercial and industrial taxpayers in Alabama. And in arguing that a single tax on motor carriers justifies their exemption from another tax, the State does not come close to proposing the massive endeavor that *Trailer Train*

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[3] The majority opinion also applies *McNamara* and acknowledges *Trailer Train*. (*See* Op. at 12–14.)

[4] In *McNamara*, Louisiana imposed a tax on "public utilities," a relatively small group of taxpayers that included railroads. 817 F.2d at 374. Notably, "public utilities" also included certain motor and water carriers. *Id.* In *Trailer Train*, Missouri taxed an activity in which only railroads engaged. 929 F.2d at 1302.

and *McNamara* refused to undertake. Like the district court, *see CSX III*, 892 F. Supp. 2d at 1310–11, I would distinguish *Trailer Train* and *McNamara* on that ground, and I would decline to follow *Lohman*'s and *Union Pacific*'s lead because they rely on those distinguishable cases.

That we must evaluate the State's justification, despite the Eighth Circuit's approach, is all the clearer after *CSX II*. There, the Court conceded that discrimination cases under the 4-R Act will often "raise knotty questions about whether and when dissimilar treatment is adequately justified." *CSX II*, 131 S. Ct. at 1114. But as the Court then insisted, "Congress has directed the federal courts to review a railroad's challenge[,] and . . . we would flout the congressional command were we to declare the matter beyond us." *Id.*

Perhaps the most compelling reason to depart from the Eighth Circuit's approach is that, under that approach, we may reach the bizarre holding that a tax discriminates against a rail carrier even though the tax puts the rail carrier at no discernible disadvantage. The majority opinion reaches just that result, concluding that the sales and use taxes discriminate against rail carriers and in favor of motor carriers even though motor carriers pay "essentially the same" tax on their fuel. (*See* Op. at 12 (refusing to evaluate the comparison between the two taxes "even though in some years . . . the State's taxing arrangement might yield a fair result").) Under the majority's approach, the sales and use taxes would

discriminate against a rail carrier even if its competitors paid four times as much tax as the rail carrier for the same commodity.

I cannot agree with that approach. Congress created the 4-R Act to stabilize railroads financially. *Dep't of Revenue v. ACF Indus., Inc.*, 510 U.S. 332, 336, 114 S. Ct. 843, 846 (1994). This goal implies that an offending tax must disadvantage railroads; I fail to see how a tax that places rail carriers in the same tax position as their competitors—or a better one—could threaten railroads' financial stability. So it is clear to me that Congress enacted § 11501(b)(4) to eliminate tax schemes that impose a greater tax burden on railroads than other taxpayers. This purpose is explicit in the first three subsections of § 11501(b), each of which prohibits taxation methods that assess or tax rail carriers' property at a *higher rate* than other taxpayers. *See* § 11501(b)(1)–(3). By outlawing "another tax that discriminates" in the final subsection, Congress specifically targeted taxes that have a similar effect as those referred to in the previous three—placing a greater tax burden on railroads than other taxpayers for the same taxable item or event. In finding discrimination against rail carriers without determining whether rail carriers have actually been disadvantaged, the majority opinion flouts the language of the statute and Congress's clear intent.

Turning now to the State's justification, I agree with the district court that the State has met its burden to show that the tax exemption for motor carriers was not discriminatory against railroads.

As I explained above, a tax discriminates against railroads in violation of § 11501(b)(4) if the tax imposes a greater tax burden on railroads than it does on comparable taxpayers. The district court found that rail carriers paid *less* state tax on fuel than motor carriers during the period in question and that, even adding the local taxes imposed on rail carriers (and without adding local excise taxes paid by motor carriers), rail carriers and motor carriers paid "essentially the same" tax. *CSX III*, 892 F. Supp. 2d at 1313. These factual findings are not challenged on appeal. And I cannot conclude from these findings that railroads have been competitively disadvantaged in any way by the sales and use taxes' exemptions for motor carriers.[5] I would hold that the State has met its burden to justify the

[5] CSX contends that, even if rail carriers face the same tax burden as motor carriers in terms of purchasing and consuming fuel, rail carriers are still disadvantaged because they must maintain their own rights-of-way (tracks) while motor carriers' rights-of-way (highways) are maintained in part by the excise taxes they pay. CSX argues that the district court's refusal to consider these uneven operating expenses in its comparison to the two taxes, *see CSX III*, 892 F. Supp. 2d at 1314–15, was error because any analysis of relative tax burdens must include an analysis of the tangible benefits received or not received.

I disagree. True, railroads have to maintain their tracks. But that burden is not a *tax* burden that the 4-R Act prohibits, and no tax affects that burden. Say, for example, that the State eliminated both the motor-fuel excise tax and the motor-carrier exemptions in the sales and use taxes, leaving a system in which rail carriers and motor carriers paid identical 4% taxes on the purchase and use of their fuel. By CSX's logic, even that totally equal tax scheme would disadvantage railroads in violation of the 4-R Act because railroads have higher overhead

differential treatment and, therefore, that the tax exemption does not discriminate against rail carriers within the meaning of § 11501(b)(4).

B. Water Carriers

The district court held that the sales and use taxes' exemptions for water carriers did not discriminate against rail carriers in violation of the 4-R Act, in part because CSX "fail[ed] to meet it[s] evidentiary burden of proof." *CSX III*, 892 F. Supp. 2d at 1316. This conclusion is not entirely unreasonable; after all, the Supreme Court in *CSX II* did hint that the rail carrier must "prove the alleged discrimination" to prevail. *CSX II*, 131 S. Ct. at 1109 n.8 ("Whether the railroad will prevail—that is, whether it can prove the alleged discrimination—depends on whether the State offers a sufficient justification . . . .").

But the district court required too much of CSX. The rail carrier bringing a § 11501(b)(4) claim can establish its prima facie case simply by showing that the tax in question exempts competitors. *See id.* at 1108 (noting that a state discriminates against one group of taxpayers by charging them a higher tax rate than another group). It then becomes the state's burden to show that the tax did not

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expenses. Motor carriers still would not be responsible for maintaining the public highways of Alabama.

The difference in right-of-way maintenance costs has no place in the comparison of tax burdens. That railroads must pay for their own tracks is the inherent burden of operating a transportation network on private rights-of-way. In other words, it is a fundamental competitive disadvantage that railroads face. Congress did not intend the 4-R Act to eliminate *all* of railroads' competitive disadvantages, only those created by taxes. And here, the State has shown that the sales and use tax exemptions for motor carriers creates no tax disadvantage for railroads.

in fact discriminate against the railroad. *See id.* at 1109 n.8 ("[W]hether [the railroad] can prove the alleged discrimination[ ]depends on whether the State offers a sufficient justification . . . .").

In requiring more from CSX than a showing that the tax exempts water carriers, the district court muddied the two-step inquiry and applied an incorrect legal standard. When a district court uses the wrong legal standard, we can remand for application of the appropriate standard. *See Kearse v. Sec'y, Fla. Dep't of Corr.*, 669 F.3d 1197, 1198 (11th Cir. 2011). Accordingly, I would remand this case so the district court can apply the correct standard (based on the existing record) and determine whether the State has offered sufficient justification for the tax exemption given to water carriers.