

## MEMORANDUM

**TO:** Tom Howells, President  
Wisconsin Motor Carriers Association

**FROM:** William M. Conley  
Tony H. McGrath

**DATE:** April 21, 2009

**RE:** 2009 A.B. 75 - Motor Vehicle Fuel Tax and No Pass Through Provisions

---

The proposed 2009 Wisconsin budget would create subchapter XIV of Chapter 77 of the Statutes, which would levy a tax on the “gross receipts” from certain sales of motor vehicle fuel. The proposed subchapter also includes a provision intended to prohibit any person subject to the tax from passing the cost of the tax down the supply chain by increasing the resale price of motor vehicle fuel. Any person who increases the selling price of motor fuel to recover the tax is subject to monetary penalties. This “no pass through” provision, however, appears facially unconstitutional, will certainly be challenged by oil companies and other suppliers and, ultimately, is likely to be struck down by the courts. Indeed, a similar provision in a New York statute was ruled unconstitutional under the Commerce Clause of the U.S. Constitution because its obvious intent is to insulate in-state consumers from the cost of the tax, and its practical effect is to pass those costs on to out-of-state consumers. This type of economic protection and favoritism by a state has repeatedly been found to violate the Commerce Clause.

The proposed subchapter is entitled “Oil Company Profits Tax.” In practice, this label will surely prove a misnomer, as the tax attaches neither to “profits,” nor to its “Big Oil” target. First, the tax is calculated based on a motor vehicle fuel “supplier’s annual gross receipts,” regardless of whether the supplier is profitable. Second, the Commerce Clause only permits a tax to be applied constitutionally to sales of motor vehicle fuel occurring in whole or in part within Wisconsin. For this reason alone, most, if not all of, the “Big Oil” companies’ sales occur beyond the state’s power to tax, and any sales that currently do occur within the State can, and likely will, be restructured with relative ease to occur outside of the state’s taxing power in the future—through use of a readily available, independent reseller, like an interstate pipeline, terminal owner, jobber or hauler.

### **ESSENTIAL PROVISIONS**

The proposal is located at section 1892 of the budget bill, 2009 A.B. 75, which states in pertinent part:

For the privilege of doing business in this state, there is imposed a tax on each supplier...of the supplier's annual gross receipts that are derived from the first sale in this state of motor vehicle fuel received by the supplier for sale in this state, for sale for export to this state, or for export to this state...

2009 A.B. 75 § 1892 (proposed Wis. Stat. § 77.9981(1)). The proposal goes on to set forth a progressive tax, ranging from 0% to 3%, based upon the supplier's annual gross receipts. "Gross receipts," in turn, is defined to include "all consideration" received for the sale of motor vehicle fuel (excluding biodiesel and ethanol products) earmarked for sale in Wisconsin. *Id.* All revenues collected under the proposed tax would be deposited into the transportation fund. *Id.* (at proposed Wis. Stat. § 77.9982(8)).

The proposal also defines the class of individuals or entities subject to the tax, called "suppliers." Borrowing an existing definition from Wis. Stat. § 78.005(14), "supplier" is defined as:

[A] person who imports, or acquires immediately upon import, motor vehicle fuel by pipeline or marine vessel from a state, territory or possession of the United States or from a foreign country into a terminal and who is registered under 26 USC 4101 for tax-free transactions in gasoline. "Supplier" also includes a person who produces in this state; or imports into a terminal or bulk plant; or acquires immediately upon import by truck, railcar or barge into a terminal; alcohol or alcohol derivative substances. "Supplier" also includes a person who produces, manufactures or refines motor vehicle fuel in this state. "Supplier" also includes a person who acquires motor vehicle fuel pursuant to an industry terminal exchange agreement or by a 2-party exchange under section 4105 of the Internal Revenue Code. "Supplier" does not include a retail dealer or wholesaler who merely blends alcohol with gasoline before the sale or distribution of the product. "Supplier" does not include a terminal operator who merely handles in a terminal motor vehicle fuel consigned to the terminal operator.

Supplier, then, has been broadly defined to include a broad class of individuals or entities that introduces motor vehicle fuel into the stream of commerce.

The bill also includes a "no pass through" provision, which is intended to protect consumers from an increase in the retail price of motor vehicle fuel to account for the cost of the tax:

No person who is subject to the tax imposed under this subchapter shall increase the selling price of motor vehicle fuel in order to recover the amount of the tax. The person primarily responsible

for increasing the selling price of motor vehicle fuel to recover the amount of the tax is subject to a penalty equal to the amount of the tax passed through to the purchaser. For purposes of this subsection, the person primarily responsible for increasing the selling price of motor vehicle fuel to recover the amount of the tax is the officer, employee, or other responsible person of a corporation or other form of business association or the partner, member, employee, or other responsible person of a partnership, limited liability company, or sole proprietorship who, as such officer, employee, partner, member, or other responsible person, has a duty to approve, confirm, ratify, or validate the selling price of motor vehicle fuel.

2009 A.B. 75 § 1892 (proposed Wis. Stat. § 77.9982(4)).

## **DISCUSSION**

### **1. The No Pass Through Provision Is Unconstitutional.**

As an initial matter, the “no pass through” provision, intended to protect Wisconsin consumers from an increased price at the pump, is almost certainly unconstitutional. In attempting to protect Wisconsin consumers from the cost of the tax, the no pass through provision effectively shifts that cost to non-Wisconsin consumers in violation of the “dormant” Commerce Clause. The “dormant” or “negative” aspect of the Commerce Clause has been repeatedly interpreted to prohibit the states from discriminating against the products or consumers of another state in order to protect their own products or consumers. *See e.g., Maryland v. Louisiana*, 451 U.S. 725 (1981); *Shell Oil Co. v. N.Y. State Tax Comm’n*, 458 N.Y.S.2d 938 (App. Div. 1983). State regulations that impermissibly favor local interests at the expense of interstate commerce are per se invalid. *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 392 (1994).

Here, the no pass through provision, if effective, would prevent suppliers from recouping the cost of Wisconsin’s tax from Wisconsin consumers. Suppliers would have to account for and cover the cost of Wisconsin’s tax elsewhere. Since Wisconsin cannot constitutionally regulate conduct beyond its borders (*see* discussion of the Seventh Circuit’s decision in *Dean Foods, infra*), Wisconsin’s no pass through provision cannot prevent suppliers with a national or regional sales footprint from passing the cost of Wisconsin’s tax through to out-of-state consumers. That being the case, even if the no pass through provision actually shielded Wisconsin consumers from the cost of Wisconsin’s tax (however unlikely that may be), the practical effect will necessarily be to shift that cost to non-Wisconsin consumers.

An attempt to prevent suppliers from passing on the cost of a similar tax has already been held unconstitutional by New York state courts for this very reason. *Shell Oil Co. v. N.Y. State Tax Comm’n*, 458 N.Y.S.2d 938 (App. Div. 1983). In *Shell Oil*, the New York Legislature imposed a 2% gross profits tax on certain oil company profits. Like the Wisconsin

bill, the New York tax sought to prohibit oil companies from passing the cost of the tax onto consumers, stating that the tax:

shall be a liability of the oil company, shall be paid by such company and shall not be included, directly or indirectly, in the sales price of its products sold in this state.

*Id.* at 941.<sup>1</sup>

Not surprisingly, shortly after its enactment several oil companies challenged the constitutionality of the enactment alleging, among other things, that the no pass through provision violated the Commerce Clause of the U.S. Constitution. *Id.* at 942. The New York Appellate Court held that a state tax regulation may be found invalid under the Commerce Clause if it evidences a discriminatory effect on interstate commerce, including a discriminatory effect on out-of-state consumers. *Id.* at 945. The Court further held that the intent and “practical effect” of the no pass through provision is to pass the cost of the tax onto out-of-state consumers.

[U]ndeniably, the State, through the antipass-through provision, is seeking to prevent an increase in the New York retail price of plaintiffs' petroleum products attributable to a cost of sale factor which the State itself created. The State thus seeks to exact tax revenues from New York sales of plaintiffs' products, but to shield its citizens from the economic impact of the tax.

*Id.* at 945-46.

Applying United States Supreme Court precedent, the court held that the no pass through provision violated the Commerce Clause because of its discriminatory effect on out-of-state consumers, rendering that provision invalid.

This inescapable conclusion places the instant case squarely under the holding in *Maryland v Louisiana*. . . . There, the Supreme Court invalidated Louisiana's “first use” tax on natural gas extracted from the outer continental shelf in the Gulf of Mexico and processed in Louisiana, because in the practical application of the tax and related legislation, Louisiana consumers of that natural gas were insulated from the burden of the tax, while at the same time the tax would be passed on to out-of-State consumers of gas from the same source. Likewise here, the potentially affected class, i.e., the taxed oil companies' customers in New York and elsewhere, are treated differently because of the pass-through prohibition and solely upon the basis of their geographical

---

<sup>1</sup> Apprehensive about the constitutionality of the above-quoted language, the New York Legislature provided that the tax would be automatically repealed if the no pass through provision were invalidated. *Id.*

location. This alone is sufficient to sustain a determination of invalidity under the commerce clause.

*Id.*

The *Shell Oil* decision is equally instructive here. The no pass through provisions and its practical effects in the New York statute and in the proposed Wisconsin statute cannot be distinguished in any meaningful way. Thus, as in New York, Wisconsin courts are equally as likely to find the no pass through provision violates the Commerce Clause of the U.S. Constitution, under binding Supreme Court precedent, by shifting the burden of the tax from Wisconsin to out-of-state consumers.

One fact separating the New York law from the proposed Wisconsin tax is that the current version of the Wisconsin bill does not contain a “self destruct” clause, repealing the tax if the no pass through provision is found to be invalid. As a result, if the Wisconsin no pass through provision were declared invalid, large oil companies, and other suppliers, would be free to pass the cost of the tax directly on to consumers through an increased price for motor vehicle fuel at the pump. This result would be directly contrary to the claimed intent of the statute.<sup>2</sup>

**2. The Proposed Law Will Not Tax Profits, Or “Big” Oil Companies.**

**a. The Tax Is Determined By Gross Receipts, Not By Profitability.**

Contrary to the subchapter’s title, the proposed tax is explicitly not a tax on profits. Rather, it levies a tax on the “gross receipts” from the sale of motor vehicle fuel. As explained below, the economic burden imposed by this tax will surely fall on Wisconsin companies over which Wisconsin actually has taxing power—mainly Wisconsin-based wholesalers, terminal owners, haulers, and retailers—most of whom operate on very thin profit margins and are most susceptible to the volatility of the oil market.

---

<sup>2</sup> The case of *Puerto Rico Dep’t of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495 (1988), also involved an excise tax that had been imposed on oil refiners, and which prohibited wholesalers from passing the cost of the tax through to retailers. *Id.* at 498-99. There, however, the sole question before the Court was whether the tax was “unconstitutional on pre-emption grounds” because of a superseding federal statute. *Id.* at 499. Ultimately, the tax was upheld on the grounds that the allegedly superseding federal law had expired. *Id.* at 504. But no challenge was raised or considered by the Court under the Commerce Clause generally or the discriminatory effect of the no pass through provision specifically.

**b. The Tax Will Not Land On “Big Oil” Companies.**

**i. To the extent construed to impose a tax on transactions occurring wholly outside Wisconsin, the tax violates the Commerce Clause of the U.S. Constitution and likely will be declared per se invalid.**

The proposed tax is levied against gross receipts “derived from the first sale in this state.” While left undefined, the term “derived” appears intended to be construed to apply the tax to receipts from a sale of motor vehicle fuel made in the distribution chain before its “first sale” in Wisconsin. Specifically, the bill calls for the tax to be levied on receipts received “for sale for export to this state, or for export to this state.” Thus, the bill purports to impose a tax on sales occurring wholly outside the state provided the fuel is earmarked for ultimate importation into, and sale in, Wisconsin. Moreover, the definition of “supplier” contains no requirement that motor vehicle fuel be imported (or acquired upon import) into Wisconsin.

The United States Supreme Court has, however, repeatedly rejected attempts to impose a state tax on economic actors operating outside a state. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (out-of-state, mail-order equipment and supply company not required to collect taxes on sales to its North Dakota customers absent a physical presence in the state even though it actively solicited business in that state with catalogs, fliers, advertisements and telephone calls); *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753 (1967) (establishing “bright line” test prohibiting state tax on a “seller whose only connection with customers in the State is by common carrier or the United States mail”). In *Quill*, the Supreme Court explained that while the “dormant” or “negative” Commerce Clause has evolved substantially over the years, particularly as that clause concerned limitation on state taxation powers, the Supreme Court has remained steadfast in its requirement of “a substantial nexus and a relationship between the tax and state-provided services.” 504 U.S. at 313.<sup>3</sup> This requirement is intended to “limit the reach of state taxing authority so as to insure that state taxation does not unduly burden interstate commerce.” *Id.* Given the Court’s continued insistence on a physical presence even for direct sales into a state, a state tax on sales occurring wholly outside the state will not survive a Commerce Clause challenge.

Nor can the tax be saved by the fact that it is levied against the “gross receipts” of a supplier “[f]or the privilege of doing business in this state.” Perhaps hoping to avoid a finding of unconstitutionality, the authors attempted to style the proposed tax to fit within another line of United States Supreme Court decisions that have acknowledged a state’s authority to “tax an apportioned share of the value generated by the intrastate and extrastate activities of a multi-state enterprise if those activities form part of a ‘unitary business.’” *Meadwestvaco Corp. v. Ill. Dept. of Rev.*, 128 S.Ct. 1498, 1502 (2008) (quoting *Hunt-Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S., 458, 460 (2000); *Mobile Oil Corp. v. Comm’r of Taxes*, 445 U.S. 425, 441-42 (1980)). This line

---

<sup>3</sup> Article I, Section 8 of the U.S. Constitution grants Congress “the Power...[t]o regulate Commerce...among the several States.” This provision has long been construed to both (1) authorize federal power over interstate commerce, and (2) prohibit certain state regulations that would impede trade between the states. *Hughes v. Oklahoma*, 441 U.S. 322, 326 (1979).

of cases is wholly unavailing. As the United States Supreme Court makes clear in *Meadwestvaco*, the fact that “the taxpayer has done some business in the taxing State” merely shifts “the inquiry . . . from whether the State may tax to what it may tax.” 128 S. Ct. at 1505. Thus, even assuming that a given supplier is a “unitary business” operating within the state, Wisconsin must still have the authority to tax the income or activity in question.

Here, the proposed tax is expressly “derived from the first sale in this state of motor vehicle fuel received by the supplier” for sale in or export to Wisconsin. Thus, the question of “what Wisconsin may tax” must focus on the sale transaction. In this respect, the Court has repeatedly cautioned that “we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax.” *Allied-Signal, Inc. v. N.J. Dir. Div. of Taxation*, 504 U.S. 768, 778 (1992) (citing *Quill*, 504 U.S. at 306-08)). The “unitary business” rule has, therefore, maintained the “imperative” that there be a “necessary limit on the States’ authority to tax value or income that cannot in fairness be attributed to the taxpayer’s activities within the State.” *Id.* at 780. For this reason, “[i]t has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.” *See Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995). Conversely, if there is no such nexus, that state may not constitutionally tax the activity. In the present inquiry, sales of motor fuel that occur wholly outside the state will fail that nexus test, even when the supplier selling the product may have a physical presence in Wisconsin and engage in other taxable activities.

The Seventh Circuit Court of Appeals—the court charged with federal appellate jurisdiction over Wisconsin, Illinois and Indiana—has also expressly held that a state statute may not constitutionally reach sales transactions occurring wholly beyond that state’s borders, and that such statutes should be construed not to do so if possible, even though the taxed entity may do substantial other business within that state. In *Dean Foods Co. v. Brancel*, 187 F.3d 609 (7<sup>th</sup> Cir. 1999), a Wisconsin statute regulating the price of milk was held not to apply to sales by Wisconsin farmers to an Illinois processor when the sales (i.e., actual transfer of ownership) took place at the processor’s facility in Illinois because the transactions “occur[ed] wholly outside Wisconsin.” *Id.* at 616. The Court noted that “[t]here is a long line of cases holding that states violate the Commerce Clause by regulating or controlling commerce occurring wholly outside their own borders.” *Id.* at 615. The Court further recognized “the long-established core principle that a statute or regulation that violates the extraterritoriality ban is per se invalid.” *Id.* at 66.

**ii. Notwithstanding The Language And Apparent Intent Of The Proposed Statute, The Tax Will Likely Be Interpreted To Not Apply To Out-Of-State Sales.**

As in *Dean Foods*, courts will likely seek to avoid determining the statute’s constitutionality by construing the statute to apply only to in-state sales. *See State v. Hall*, 207 Wis. 2d 54, 83-84, 557 N.W.2d 778, 789 (1997) (“Statutes should be construed to avoid constitutional questions.”). Given its many vague terms, a court could construe the tax to attach only to sales occurring within the state, thereby avoiding the question of the proposed tax’s

constitutionality.<sup>4</sup> Any such interpretation would necessarily have the effect of shifting the tax burden from out-of-state “Big Oil” to those who actually make “the first sale” in Wisconsin – more likely than not to be local Wisconsin companies.

**iii. The Cost of The Tax Is Unlikely To Be Borne By “Big Oil” Even If Currently Selling Directly Into Wisconsin.**

To the limited extent oil companies or other suppliers currently make direct sales into Wisconsin, they can easily restructure their business to avoid or transfer the cost of this tax in the future. First, those oil companies and other suppliers that choose to sell their product for resale in Wisconsin are likely to avoid the tax by structuring their transactions to occur outside of Wisconsin. For example, a common practice in the industry is to engage third-party jobbers, pipelines, terminal operators and haulers to transport motor vehicle fuel from point to point. Large oil companies can tweak their existing relationships to require that the buyer (whether the jobber, pipeline, terminal owner, hauler, wholesaler or retailer) takes ownership of the fuel prior to it entering Wisconsin. **Not only will this result in Wisconsin-based companies incurring the tax liability,<sup>5</sup> they will also incur the expense of creating a new channel of distribution.**

Second, the demand for motor vehicle fuel is universal. Some oil companies may choose to exit the Wisconsin market altogether (or limit the amount of fuel they sell in Wisconsin), and sell their supply of motor vehicle fuel into other states, rather than incur the cost of defeating the tax in court and/or risk ultimately being forced to pay it. If the balance between supply and demand is altered in this manner, the retail price of motor vehicle fuel will increase for Wisconsin consumers.

**3. Wisconsin Runs A Financial Risk By Enacting The Tax.**

If the proposed tax is enacted, in light of the *Shell Oil* case and the United States Supreme Court precedent on which it relied, suppliers will almost certainly pay the tax under protest and commence litigation to challenge the law’s constitutionality. *See* Wis. Stat. § 71.90.<sup>6</sup> The protracted litigation and subsequent appeals may last well into the next budget cycle. The

---

<sup>4</sup> For example, such a construction is possible by narrowly defining the term “derived” as discussed above. Another possibility might be for a court to construe general language imposing the tax “[f]or the privilege of doing business in this state” as indicating an intent to apply the tax only to sales taking place within the state of Wisconsin.

<sup>5</sup> Indeed, the bill requires that if a supplier is not taxed on the sale of motor fuel then “any person” that uses or possesses that untaxed motor fuel must submit a report to the Department of Revenue and pay the tax based on the purchase price of the fuel. 2009 A.B. 75, § 1892 (at proposed Wis. Stat. § 77.9981(2)). Given the territorial restrictions on the state’s taxing power (*see* discussion, *supra*), this requirement can only apply to businesses and individuals within Wisconsin.

<sup>6</sup> Even if there were no state remedy, the suppliers would have a federal cause of action for violation of their constitutional rights. 42 U.S.C. § 1983. In that case, the parties challenging the tax would also be able to seek reimbursement for their legal fees. 42 U.S.C. § 1988.

state would then have to refund the taxes paid under protest, with interest, to the suppliers in the likely event that the tax or the no pass through provision were declared unconstitutional. *Id.* (“Any deposited amount which is refunded shall bear interest at the rate of 9% per year during the time the funds were on deposit.”).

The cost of litigation, interest on any refunds, and a potential award of attorneys fees to the parties challenging the tax would create a significant multi-million dollar liability for the state. Ironically, rather than generating revenue from out-of-state “big oil” companies to help maintain the state’s roads, the proposal’s shaky legal standing could result in a financial windfall for those companies at the expense of Wisconsin taxpayers.

### **CONCLUSION**

In short, the proposed tax, if passed, will almost certainly be challenged in court, and one or more of its provisions likely declared unconstitutional. As a result, the economic costs of the tax will be borne by Wisconsin small businesses and Wisconsin consumers, in direct contradiction to the bill’s intent.