PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 19-1089

CSX TRANSPORTATION, INC.,

Plaintiff - Appellant,

v.

SOUTH CAROLINA DEPARTMENT OF REVENUE; W. HARTLEY POWELL, Agency Director of the South Carolina Department of Revenue,

Defendants - Appellees.

No. 19-1154

CSX TRANSPORTATION, INC.,

Plaintiff - Appellee,

v.

SOUTH CAROLINA DEPARTMENT OF REVENUE; W. HARTLEY POWELL, Agency Director of the South Carolina Department of Revenue,

Defendants - Appellants.

Appeals from the United States District Court for the District of South Carolina, at Columbia. Margaret B. Seymour, Senior District Judge. (3:14-cv-03821-MBS)

Submitted: March 26, 2020 Decided: May 20, 2020

Before THACKER and HARRIS, Circuit Judges, and David J. NOVAK, United States District Judge for the Eastern District of Virginia, sitting by designation.

Reversed and remanded by published opinion. Judge Thacker wrote the opinion, in which Judge Harris and Judge Novak joined.

Stephen D. Goodwin, Zachary A. Kisber, Memphis, Tennessee, Misty Smith Kelley, BAKER, DONELSON, BEARMAN, CALDWELL & BERKOWITZ, PC, Chattanooga, Tennessee; John C. von Lehe, Jr., Bryson M. Geer, NELSON MULLINS, Charleston, South Carolina, for Appellant/Cross-Appellee. Thomas Parkin C. Hunger, OFFICE OF THE ATTORNEY GENERAL OF SOUTH CAROLINA, Columbia, South Carolina; Nicole M. Wooten, Adam J. Neil, Jason P. Luther, SOUTH CAROLINA DEPARTMENT OF REVENUE, Columbia, South Carolina, for Appellee/Cross-Appellant.

THACKER, Circuit Judge:

In this case,[1] CSX Transportation, Inc. ("Appellant") argues the South Carolina Real Property Valuation Reform Act ("SCVA") impermissibly discriminates against railroads in violation of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4-R Act"). Though the district court determined the SCVA is a discriminatory tax, it nonetheless determined South Carolina had provided sufficient justification for such discrimination. Appellant challenges this decision and argues that South Carolina failed to justify its discriminatory tax.

In the event we hold for Appellant, the State has raised a "conditional cross appeal" challenging two preliminary issues. It first argues the SCVA is not a tax at all. And, even if it is a tax, it argues the district court erred in using the wrong comparison class to evaluate Appellant's claim of discrimination. Specifically, the district court held the appropriate comparison class was all other industrial and commercial real property taxpayers in South Carolina.

We reject both of the State's arguments and agree with Appellant that South Carolina failed to justify its discriminatory tax. We therefore reverse the district court's decision.

[1] This is the second time we have heard this case on appeal. The first time this case was before us, we determined Appellant was challenging a tax. *See CSX Transp., Inc. v. S.C. Dep't of Revenue*, 851 F.3d 320 (4th Cir. 2017). We now evaluate whether that tax is unlawfully discriminatory.

I.

A.

Statutory Background

1.

Congress enacted the 4-R Act to "'restore the financial stability of the railway system of the United States,' among other purposes," and sought to achieve this goal by targeting state and local tax schemes that discriminate against railroads. *CSX Transp., Inc. v. Ala. Dep't. of Revenue*, 562 U.S. 277, 280 (2011) ("*CSX I*") (quoting § 101(a), 90 Stat. 33). The 4-R Act, now codified at 49 U.S.C. § 11501, prohibits states and localities from engaging in four types of discriminatory taxation. Relevant here is subsection (b)(4) of the 4-R Act, which provides that states and localities may not "[i]mpose another tax that discriminates against a rail carrier." 49 U.S.C. § 11501(b)(4). We have explained that subsection (b)(4) "was intended as a catchall provision designed to prevent *discriminatory* taxation of a railroad carrier *by any means* and . . . [it] clearly and unambiguously prohibits *all forms of discriminatory taxation* of railroads." *CSX Transp., Inc. v. S.C. Dep't of Revenue*, 851 F.3d 320, 328 (4th Cir. 2017) (internal quotation marks omitted) (emphases in original) (citation omitted).

2.

In 2006, South Carolina enacted the SCVA, S.C. Code Ann. §§ 12-37-3110 *et seq.*, which limits increases in the appraised value of most commercial and industrial real properties to 15% within a particular five year period for property tax purposes. *See CSX Transp., Inc.*, 851 F.3d at 323. However, the SCVA cap does not apply to real property

valued by the unit valuation method,[2] such as railroad property. *See id.* at 324. Thus, railroads do not benefit from the 15% cap. "It is that difference between the way South Carolina law treats railroad property and the way it treats other commercial and industrial property that is the subject of the present case." *Id.*

B.

Relevant Facts and Procedural History

Appellant is a common carrier by railroad operating in 23 states, including South Carolina. Appellant sued the South Carolina Department of Revenue and its director (collectively, the "State"), who are responsible for administering and enforcing South Carolina's revenue laws, including tax assessment and the SCVA cap. Appellant alleges that, by denying it the SCVA cap, the State discriminates against railroads in violation of the 4-R Act. Specifically, Appellant alleges that for the 2014 tax year, its property tax assessment was $40,727,560. Appellant estimates that its 2014 property tax assessment would be $33,551,735 if given the benefit of SCVA's 15% cap. According to Appellant, the State's appraisal of its real property in the period between tax years 2007 and 2012 increased approximately 51%. Based on evidence presented at trial, Appellant's appraised

[2] The unit valuation method, and its application to railroads, is explained in more detail in our prior opinion in this case. *See CSX Transp., Inc.*, 851 F.3d at 322–24. Importantly, though, per the unit valuation method, the property is first appraised and then assigned an assessment value. After assessing railroad property, South Carolina applies an "equalization factor" which lowers the railroad's assessment to account for disparities in their fair market value compared to other commercial and industrial properties. Despite the equalization factor's application to the *assessed value*, increases in railroad *appraisals* are not limited by the SCVA cap.

property value was $263,686,352 in 2007. By 2010, it had increased 19.35%, to $314,714,486; and by 2012, it had increased a total of 50.85%, or to just over $398,000,000.

The complaint requested declaratory judgment as well as preliminary and permanent injunctions prohibiting the imposition of taxes based on appraised values for Appellant's real property above the 15% cap. After a hearing, the district court granted Appellant's preliminary injunction. After a bench trial, however, the district court granted judgment for the State, holding Appellant had not shown that it was challenging the imposition of a "tax" within the meaning of subsection (b)(4) of the 4-R Act because the SCVA does not itself impose a tax but instead only caps increases in appraisal values. We reversed on appeal, concluding that Appellant was in fact challenging the imposition of a tax. *See CSX Transp., Inc.*, 851 F.3d at 325–26. We remanded to the district court to determine in the first instance whether the challenged tax was discriminatory. *See id.* at 332.

On remand, the district court held that though Appellant had made a prima facie showing of discriminatory tax treatment, the State provided sufficient justification such that the SCVA cap does not violate the 4-R Act in this instance. Appellant timely appealed again, arguing the State has not provided sufficient justification for its discriminatory tax. The State filed a conditional cross appeal[3] challenging two preliminary issues: (1) the

[3] The State's conditional cross appeal is unique. The State won on remand from the earlier appeal in this case, and now through this conditional cross appeal is asking this court to alter its earlier ruling on the "tax" issue. Moreover, the comparison class issue is one

district court's determination, dictated by our prior decision, that Appellant challenged a "tax" rather than a tax exemption; and (2) the district court's determination that, for purposes of determining whether Appellant made a prima facie showing of discrimination, the proper comparison class is "other commercial and industrial real property taxpayers in South Carolina." J.A. 436.[4]

II.

Because this is an appeal from a bench trial, we review de novo the legal conclusions from the undisputed findings of fact by the district court. *See CSX Transp., Inc. v. S.C. Dep't of Revenue*, 851 F.3d 320, 325 (4th Cir. 2017).

III.

In evaluating a claim of discrimination pursuant to 49 U.S.C. § 11501(b)(4), we use a two step inquiry. *See BNSF Ry. Co. v. Tenn. Dep't of Revenue*, 800 F.3d 262, 271 (6th Cir. 2015). First, "[t]he plaintiff bears the initial burden of establishing a prima facie case of discriminatory tax treatment." *Id.* (citing *CSX I*, 562 U.S. 277, 288 n.8 (2011)). Second, "[i]f the plaintiff does so, the burden then shifts to the defendant taxing authority to offer a 'sufficient justification' for the differential tax treatment." *Id.* If the defendant cannot offer sufficient justification, the tax violates § 11501(b)(4). *Id.*

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this court would necessarily need to resolve in the main appeal, regardless of the State's cross appeal. In essence, the State wants to have its cake and eat it too -- it wants to win, and it also apparently wants a holding on the books that for a prima facie case of discrimination, the State's preferred comparison class is the appropriate comparator.

[4] Citations to the "J.A." refer to the Joint Appendix filed by the parties in this appeal.

A.

Prima Facie Showing

As an initial matter, the State argues in its cross appeal, once again, that Appellant has not challenged a "tax" within the meaning of the 4-R Act. Instead, the State argues the SCVA cap is a property tax exemption -- that is, the cap exempts taxpayers from paying any taxes based on appraisals above the 15% increase limit. But, we conclusively answered this question in the earlier appeal in this case when we held Appellant's "action *plainly* challenged the imposition of a tax." *See CSX Transp., Inc.*, 851 F.3d 320, 326 (4th Cir. 2017) (emphasis supplied). That ruling stands. *See Dillon v. BMO Harris Bank, N.A.*, 787 F.3d 707, 715 (4th Cir. 2015) ("[W]hen a court decides upon a rule of law, that decision should continue to govern the *same issues* in subsequent stages in the same case." (emphasis in original) (citation omitted)). Next, we consider whether Appellant has made a prima facie showing that the challenged tax is discriminatory. In *CSX I*, the Supreme Court held "'discriminates' in subsection (b)(4) carries its ordinary meaning, and that a tax discriminates under subsection (b)(4) when it treats 'groups [that] are similarly situated' differently without sufficient 'justification for the difference in treatment.'" *Ala. Dep't. of Revenue v. CSX Transp., Inc.*, 135 S. Ct. 1136, 1141 (2015) ("*CSX II*") (quoting *CSX I*, 562 U.S. at 287).

The first step in this inquiry, then, is determining the appropriate similarly situated group, i.e., the "comparison class," by which to evaluate whether the tax is discriminatory. *CSX II*, 135 S. Ct. at 1141. Subsection (b)(4) contains no direction on this point, "leaving the comparison class to be determined as it is normally determined with respect to

discrimination claims." *Id.* That is, it "depends on the theory of discrimination alleged in the claim." *Id.* "What subsection (b)(4) requires . . . is a showing of *discrimination*—of a failure to treat similarly situated persons alike. A comparison class will thus support a discrimination claim only if it consists of individuals similarly situated to the claimant." *Id.* at 1141–42. Importantly, "similarly situated" in this context "cannot be so narrow" as it is in Equal Protection cases. *Id.* at 1142. Otherwise, subsection (b)(4) would be deprived "of all real-world effect, providing protection that the Equal Protection Clause already provides." *Id.*

Here, the district court determined the appropriate comparison class was all "other commercial and industrial real property taxpayers in South Carolina." J.A. 436. However, the State argues in its cross appeal that the appropriate comparison class is only those South Carolina taxpayers that are assessed using the unit valuation method. Thus, the State would argue that the only similarly situated taxpayers are those other industries excluded from the SCVA cap. The district court rejected this argument. We do as well.

The Supreme Court made clear in *CSX II*,

> When a railroad alleges that a tax targets it for worse treatment than local businesses, all other commercial and industrial taxpayers are the comparison class. When a railroad alleges that a tax disadvantages it compared to its competitors in the transportation industry, the railroad's competitors in that jurisdiction are the comparison class.

CSX II, 135 S. Ct. at 1141. Appellant's claim is precisely the type of claim the Court first described regarding the comparison class -- Appellant alleges other local businesses benefit from the SCVA cap but that it is excluded because South Carolina uses the unit valuation

method to assess its property taxes. Indeed, Appellant argues its appraisals between 2007 and 2014 increased by 51%, and that its 2014 property tax assessment would have decreased by over $7,000,000 if it were able to benefit from the SCVA cap.

Thus, we reject the State's cross appeal and hold that Appellant has made a prima facie showing of discriminatory tax treatment based on the appropriate comparison class of other commercial and industrial real property taxpayers in South Carolina.

B.

Sufficient Justification

1.

In the second step of the subsection (b)(4) analysis, the burden shifts to the State to provide sufficient justification for its discriminatory tax treatment. Despite Appellant's contention that no justification defense is available to the State, the Supreme Court has held "[a] State's tax discriminates *only where the State cannot sufficiently justify* differences in treatment between similarly situated taxpayers." *CSX II*, 135 S. Ct. at 1143 (emphasis supplied).

In *CSX II*, Alabama imposed sales and use taxes on railroads when they purchased diesel fuel but exempted their competitors -- motor carriers and water carriers -- from those taxes. *See* 135 S. Ct. at 1140. Alabama proffered separate justifications for its discriminatory tax scheme. *See id.* at 1143–44. First, as to motor carriers, Alabama claimed it subjected them to a comparable fuel-excise tax. S*ee id.* at 1143. Then, Alabama argued, among other things, that it was compelled by federal law to provide a tax exemption to the water carriers but not rail carriers. *See id.* at 1144. The Eleventh Circuit rejected

Alabama's motor carrier justification and held that a separate tax could not offset a discriminatory tax for purposes of subsection (b)(4). *See id.* It did not consider Alabama's water carrier justifications. *See id.*

Before the Supreme Court, the rail carrier argued Alabama's motor carrier justification was not applicable to the subsection (b)(4) analysis because "the appropriate inquiry is whether the challenged *tax* discriminates, not whether a tax code as a whole does so." *CSX II*, 135 S. Ct at 1143 (emphasis in original). The Court rejected that argument and held "an alternative, roughly equivalent tax is one possible justification that renders a tax disparity nondiscriminatory." *Id.* Though the Court recognized "federal courts are ill qualified to explore the vagaries of state tax law," it held "Congress assigned this task to the courts" anyway. *Id.* at 1144. "There is simply no discrimination when there are roughly comparable taxes. If the task of determining when that is so is 'Sisyphean,' . . . it is a Sisyphean task that the statute imposes." *Id.* (internal citation omitted). Thus, the Court remanded for a determination of whether Alabama's alternative tax on motor carriers was "rough[ly] equivalent." *Id.* And because the appellate court had failed to consider Alabama's water carrier justifications in the first instance, the Court instructed it to do so on remand. *See id.*

Importantly, the Court did not instruct the appellate court to evaluate the proffered justifications with any particular level of scrutiny. But because the Supreme Court clarified that the 4-R Act does not merely provide the same protection as the Equal Protection Clause, *see CSX II*, 135 S. Ct at 1142, we think a proposed justification must do more than survive a rational basis review. And, if the standard were to be as high as strict scrutiny,

we think the Supreme Court would have said so. Thus, using these guideposts, we are left to determine whether, based on the record, we are persuaded that the State has "sufficient justification for the difference in treatment." *CSX II*, 135 S. Ct. at 1138 (internal quotation marks omitted).

2.

Here, the State offers three justifications for its discriminatory tax scheme: (1) the equalization factor applied to railroad assessments, (2) the combined effect of other tax exemptions applied to rail carriers, and (3) assessable transfers of interest ("ATI")[5] which trigger new appraisals. We deal with each in turn.

a.

The Equalization Factor

The State argues that a 20% "equalization factor" it applies to lower rail carriers' assessed values provides justification for the exclusion of rail carriers from the SCVA appraisal cap. We disagree.

As we explained in the first appeal in this case, the equalization factor is a reduction in the assessed value of property owned or leased by transportation companies for hire, including railroads, "to help negate disparities between the fair market valuation of their properties and those of other commercial/industrial and manufacturing properties." *CSX Transp., Inc.*, 851 F.3d at 323. The record assures us that the equalization factor "correct[s]

[5] An ATI is "a transfer of an existing interest in real property that subjects the real property to appraisal." S.C. Code Ann. § 12-37-3130(4).

inequities resulting from different levels of [the statutory] assessment [ratios] for other commercial/industrial and manufacturing property." J.A. 179. It also corrects the differences in the fair market value assessment of those properties. *See id.* at 180. However, the record is devoid of any evidence to demonstrate how the equalization factor is connected to or justifies the SCVA cap.

South Carolina enacted the equalization factor in 1991 to comply with the 4-R Act. The equalization factor was intended to remedy two forms of tax discrimination prohibited by the 4-R Act. It remedied the "de jure" discrimination of the statutory assessment ratios, *see* J.A. 179, 238–39, as well as the "de facto" discrimination of assessors failing to assess commercial and real property at 100% percent of their fair market value, *see id*. at 179, 239. In 1991, South Carolina had yet to enact the SCVA cap, and, consequently, it had not considered whether the equalization factor remedied discrimination of the nonexistent SCVA cap.

Even assuming, as the State argues, that the enactment date of the equalization factor is irrelevant, we cannot conclude the equalization factor justifies the denial of the SCVA cap to railroads. The equalization factor ensures railroads are similarly situated to other commercial/industrial and manufacturing properties in the calculation of the *assessed* value. But the calculation of the assessed value occurs *after* the calculation of the *appraised* value. And the appraised value is where the benefit of the SCVA cap would come into play for railroads because it limits the increase in *appraisals* to 15% over a five year period. As a result, the equalization factor negates any disparity in the calculation of the assessed value. The equalization factor does not negate, however, the disparity in the

initial calculation of the appraisal value. This disparity carries through to the resulting taxable value of the railroad property.

Accordingly, we are not persuaded by the record that the equalization factor provides sufficient justification for denying railroads the benefit of the SCVA cap.

b.

Tax Exemptions

The State next argues the combination of tax exemptions afforded to Appellant and other railroads offsets any increase in property taxes created by denying them the SCVA cap. Specifically, the State relies on the combined effect of four exemptions: (1) sales tax on diesel fuel; (2) sales tax on railroad cars, locomotives, and parts; (3) user fees for diesel fuel; and (4) property tax for pollution control facilities. Though Appellant argues the discriminatory tax cannot be offset by the State's tax scheme as a whole, as we have explained, the Supreme Court directs courts to undertake the "Sisyphean task" of evaluating these kinds of proffered justifications. *CSX II*, 135 S. Ct. at 1144. As the Court explained in *CSX II*, the alternative taxes must be "roughly equivalent" to justify the tax disparity. *Id.* at 1143–44. We are not persuaded by the record that the tax exemptions identified by the State here are roughly equivalent to the benefit railroads would receive from the SCVA cap.

Though the Supreme Court did not provide specific guidelines for a "roughly equivalent" analysis in *CSX II*, we find the Eleventh Circuit's decision on remand persuasive. *See CSX Transp., Inc. v. Ala. Dep't of Revenue*, 888 F.3d 1163, 1179 (11th Cir. 2018). The Eleventh Circuit undertook an extensive analysis, comparing the figures

of each tax. In doing so, it concluded "roughly equivalent" retains its ordinary meaning: "two taxes are roughly equivalent if the rates they impose approximate one another." *Id.* at 1179. The Eleventh Circuit noted "roughly equivalent" does not mean "perfectly equivalent." *Id.* In so concluding, it held Alabama's motor carrier sales tax exemption was justified because an excise tax that motor carriers paid was roughly equivalent to the sales and use tax on diesel fuel that rail carriers paid. *See id.* The Eleventh Circuit further reasoned "the average rates that rail carriers and motor carriers paid [on the sales and use tax and excise tax respectively] differed only by some quantity between less-than-half-of-one cent and 3.5 cents per gallon, favoring one as many times as the other." *Id.* (internal quotation marks omitted).

The task is slightly more complicated here because the State does not offer a one to one tax comparison. Instead, the State asks us to compare the benefit railroads receive from four separate tax exemptions to the benefit they would receive if the SCVA cap applied to them. Based on the record, however, we conclude the State failed to produce evidence as to how the sales tax exemptions are comparable and roughly equivalent to the property taxes at issue here. The State also failed to produce evidence of how a sales tax paid by commercial and industrial taxpayers was roughly equivalent to the property tax paid by rail carriers. In fact, John P. McCormick, a general manager for policy in the Department of Revenue Office, testified at trial that he did not "know anything about that, as far as the SCVA cap on the property taxes or the comparison, making that comparison between sales tax and property tax." J.A. 289. During his testimony, McCormick also testified that, in addition to the sales tax exemptions available to railroads, there are other

sales tax exemptions available to benefit commercial and industrial taxpayers that are not available to railroads.

Moreover, the property tax exemption for pollution control facilities identified by the State is not relevant for purposes of this inquiry. S.C. Code Ann. § 12-37-220(A)(8) exempts "all facilities or equipment plants . . . ." Accordingly, the exemption is available to *both* Appellant and the comparison class that is treated more favorably with the benefit of the SCVA cap.

In our view, the record demonstrates little, if any, evidence of roughly equivalent taxes justifying denying railroads the SCVA cap. And, our review of the evidence regarding the railroad sales tax exemptions reveals that the value of those exemptions is less than the value of comparable exemptions available to other commercial and industrial taxpayers. We thus conclude the tax exemptions identified by the State are not sufficient to justify denying the SCVA cap to railroads.

c.

Assessable Transfers of Interest

Finally, the State attempts to justify its discriminatory tax based on the application of ATIs to property other than railroad property. The State argues that unlike railroad property, the sale of commercial and industrial property triggers an ATI where the property is reassessed at full fair market value without the SCVA cap. The State also avers that railroad property does not regularly change ownership or cause improvement, and, therefore, railroad property is not regularly reassessed at fair market value. The State also

argues that, at a minimum, the combined effect of all of its arguments justifies the tax discrimination.

For its part, Appellant argues the State's claim in this regard concerns mere speculation of the regularity of the sale and improvements of railroad property. Speculation aside, Appellant asserts South Carolina law permits only partial recoupment from the sale or improvements of commercial and industrial property, and, consequently, South Carolina cannot recoup the full market value of the property as the State claims.

We are not persuaded that the ATI argument, alone or in combination with the State's other arguments, justifies the State's discriminatory tax. First, we agree with Appellant that the record contains only speculative evidence of the frequency or value of improvements and sales concerning railroad property. Sanford Houck, Jr., special projects coordinator for the Department of Revenue, testified for the State at trial that taxpayers not under the unit valuation method transfer properties between 5% and 20% annually per county in South Carolina. Significantly, however, Houck did not quantify the percentage of the transfer of properties under the unit valuation method. Instead, Houck testified, "Properties under the unit valuation [method] typically never -- we never see sales, or very seldom do we see sales." J.A. 227. This evidence is insufficient for us to determine with any accuracy a comparison of the value of ATI's for railroad and nonrailroad properties.

Likewise, we hold that the record does not support the State's argument than an ATI of nonrailroad property triggers reassessment at the *full* fair market value. In fact, S.C. Code Ann. § 12-37-3135 allows a 25% exemption from property taxes arising from an ATI

at fair market value. But, of note, the exemption is not available to railroad property. *See* S.C. Code Ann. § 12-37-3135(B)(1). In other words, the ATI of commercial real property is assessed at only 75% of its value whereas the ATI of railroad property would be assessed at the full fair market value. We fail to see how a higher ATI assessment for railroads justifies the denial of the SCVA appraisal cap. Given the weaknesses in each of the three proffered justifications, we reject the State's arguments that their cumulative effect provides sufficient justification for the discriminatory tax.

IV.

For the foregoing reasons, we reject the State's cross appeal and hold that it has failed to provide sufficient justification for its discriminatory tax. Therefore, the judgment of the district court is

REVERSED AND REMANDED.