



WISCONSIN LEGISLATIVE COUNCIL

*Terry C. Anderson, Director
Laura D. Rose, Deputy Director*

TO: SPEAKER MICHAEL HUEBSCH
FROM: William Ford, Senior Staff Attorney
RE: Oil Supplier Gross Receipts Tax "Anti-Pass Through" Provision and the Commerce Clause
DATE: February 26, 2007

INTRODUCTION

This memorandum, prepared at your request, discusses the constitutionality, under the Commerce Clause of the U.S. Constitution, of the provision in SECTION 2496 of 2007 Senate Bill 40 that would prohibit suppliers of motor vehicle fuel from increasing the cost of that fuel to recover the cost of an assessment that would be imposed on suppliers under the bill.

The memorandum first describes SECTION 2496 of 2007 Senate Bill 40 and then briefly describes the Commerce Clause of the U.S. Constitution. Next, the memorandum describes a 1983 decision of the Supreme Court of New York, Appellate Division (referred to as the "Shell Oil" decision), which held that a New York statute prohibiting oil companies from passing on a gross receipts tax to consumers violated the Commerce Clause of the U.S. Constitution. [*Shell Oil Company v. New York State Tax Commission*, 91 A. D. 2d 81; 458 N.Y. S. 2d 938; 1983 N. Y. App. Div. LEXIS 16099, January 6, 1983]. Finally, in a "Comment" section, the memorandum offers some observations on the constitutionality of SECTION 2496 of 2007 Senate Bill 40. The comment states it is possible a court would find it violates the Commerce Clause of the U.S. Constitution because its practical effect will be to pass on the cost of the assessment to out-of-state customers of suppliers subject to the assessment.

A copy of the court's opinion in *Shell Oil* (the Lexis version) is attached to this memorandum. In this memorandum, the provisions of SECTION 2496 of 2007 Senate Bill 40 and the New York statute prohibiting oil companies from passing on the gross receipts tax are referred to as "anti-pass through" provisions.

ANTI-PASS THROUGH PROVISION IN 2007 SENATE BILL 40

SECTION 2496 of 2007 Senate Bill 40 imposes on suppliers of motor vehicle fuel an assessment of 2.5% of the supplier's 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. The anti-pass through provision of this section reads as follows:

No supplier who is subject to the assessment imposed under this subchapter shall take any action to increase or influence the selling price of motor vehicle fuel in order to recover the amount of the assessment. A supplier who takes any action to increase or influence the selling price of motor vehicle fuel to recover the amount of the assessment is subject to a penalty equal to the amount of the gain the supplier received from any increase in the selling price that is implemented in order to recover the assessment amount or imprisonment of not more than 6 months, or both.

SECTION 2496 provides that, at the Secretary of Revenue's request, the Attorney General may represent the state, or assist a district attorney, in prosecuting alleged violations of the anti-pass through provision. In addition, the Department of Revenue is authorized to audit any supplier who is subject to the assessment in order to determine whether the seller may have violated the anti-pass through provision. The Department of Revenue is required annually to submit a report to the Governor and the Legislature that contains information on all audits conducted.

THE COMMERCE CLAUSE OF THE U.S. CONSTITUTION

Under art. I, s. 8 of the U.S. Constitution (the "Commerce Clause"), Congress is given the power "to regulate commerce with foreign nations and among the several states, and with the Indian tribes."

Although the Commerce Clause is framed as a grant of power to Congress, the U. S. Supreme Court has long held that this constitutional provision limits the power of states to interfere with national and international free trade. One of these limits is that a state may not enact legislation that unduly discriminates against out-of-state businesses or activities. The protection of national free-trade which the Commerce Clause affords against state taxation applies even if the tax is imposed on an otherwise taxable activity or event. In addition, the discrimination need not be expressed in an explicit distinction in the tax rates which apply to local, as opposed to out-of-state businesses, in order for the text to be held to violate the Commerce Clause. The U.S. Supreme Court has expressly noted that it is its duty to determine whether the statute under attack, whatever its name may be, will in **practical operation** work discrimination against interstate commerce.

THE SHELL OIL DECISION

The relevant facts relating to the *Shell Oil* decision are as follows. Chapters 271 and 272 of the New York Laws of 1980, imposed a 2% gross profits tax on certain oil company profits in New York. These laws directed 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." The law also required an oil company subject to the tax to file with its tax return a certification under oath that it has not included the tax in the sales price of its products sold in New York.

A number of oil companies challenged the constitutionality of both the tax and the anti-pass through provision under a number of legal theories. This memorandum describes only the portion of the court's decision relating to the constitutionality under the Commerce Clause of the anti-pass through provision.

The *Shell Oil* court began its analysis with the observation that there was nothing in the New York statute or its legislative history to indicate that the state is anything but neutral with respect to the effect of the anti-pass through provision on the oil companies' operations outside of New York or on their non-New York customers. However, the court noted that:

Even in the absence of a discriminatory purpose, however, Commerce Clause invalidity can be established on the basis of the discriminatory effect of a challenged state tax or regulation. Determining whether there is such a discriminatory effect requires an examination of the entire statutory scheme of the challenged legislation and an assessment of whether its practical operation results in different treatment based upon the geographical location of the affected class, within or without the state... . Most importantly here, the invalidity of a state statute under the Commerce Clause may arise out of discrimination visited upon a class of out-of-state consumers of interstate products; it is not limited to discrimination against classes of interstate commercial or industrial entities. [*Shell Oil, op cit.*, page 10 of Lexis version.]

The court concluded that the anti-pass through provision violated the Commerce Clause. First, the court noted that New York's anti-pass through provision seeks to prevent an increase in the New York retail price of petroleum products attributable to a cost of sale factor which the state itself created. Second, the court noted that the effect of the anti-pass through provision would be for the oil companies to attempt to recoup the cost of the tax on New York sales at the expense of non-New York purchasers of their products. Third, the court noted that oil companies have the market power to pass on a substantial part of the tax to out-of-state customers. Based on these factors, the court concluded that "it appears clear to us that the practical effect of the prohibition is to shift the direct burden of the tax from the companies' New York customers to their out-of-state customers." [*Shell Oil, op. cit.*, page 10 of Lexis version.]

COMMENT

Because the provisions of the anti-pass through provision in SECTION 2496 of 2007 Senate Bill 40 and the New York anti-pass through provision struck down in *Shell Oil* are similar, it appears that, the anti-pass through provision in Senate Bill 40 raises the legal issue of whether it violates the Commerce Clause of the U.S. Constitution because its practical effect will be to pass on the cost of the assessment to out-of-state customers of suppliers subject to the assessment.

Please note that the *Shell Oil* decision, because it is a decision of a New York court, is not a precedent for purposes of review of the constitutionality of SECTION 2496 of 2007 Senate Bill 40. However, the rationale for the *Shell Oil* decision may be indicative of how a Wisconsin court would assess a Commerce Clause challenge to the constitutionality of the anti-pass through provision in Senate Bill 40.

There is, in addition, a difference between the New York anti-pass through provision invalidated in *Shell Oil* and the provision in Senate Bill 40 that may be relevant in considering the constitutionality of the latter. The New York provision prohibited oil companies from passing on the tax in the sales price of products sold in New York. Read literally, the Senate Bill 40 anti-pass through provision prohibits suppliers from passing on the assessment in the sales price of products sold anywhere. Therefore, it could be argued that the effect of the anti-pass through provision in Senate Bill 40 is not to shift the burden of the assessment to out-of-state customers of suppliers. However, given the difficulty of determining whether a Wisconsin supplier subject to the assessment has passed on the amount of the assessment anywhere the supplier does business, whether in Wisconsin or in some other state or nation, a court may not see this as a significant difference between the Senate Bill 40 anti-pass through provision and the provision invalidated in *Shell Oil*.

Please contact me at the Legislative Council staff offices if I can provide further information.

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Attachment