ACTION ON DECISION

Subject: Trafigura Trading LLC v. United States, 29 F.4th 286 (5th Cir. 2022).

Issues: Whether a taxpayer is entitled to a tax refund under I.R.C. § 4611(b) on crude oil exports because the tax violates the Export Clause of the United States Constitution, U.S. Const. art. I, § 9, cl. 5.

Discussion: Section 4611(b)(1)(A) imposes a tax on "any domestic crude oil [that] is used in or exported from the United States." This tax, in turn, partially funds the Oil Spill Liability Trust Fund (OSLTF), which is used to clean up oil spills. In the case at issue, the taxpayer, a commodity trading company, purchased and exported crude oil to locations outside of the United States. After remitting the tax payment pursuant to § 4611(b), the taxpayer requested a refund of the amount paid, contending that § 4611(b) imposes a tax that is unconstitutional under the Export Clause. The Internal Revenue Service (Service) denied the claim.

The taxpayer filed a complaint in federal district court seeking a refund of the § 4611(b) excise taxes it had remitted and argued that the direct tax on exports violated the U.S. Constitution. The government argued that § 4611(b) is a valid user fee rather than an impermissible tax on exports because the OSLTF pays for oil pollution cleanup costs and the exporter benefits from a liability cap related to oil spills. In Pace v. Burgess, 92 U.S. 372 (1875), the Court held that a user fee imposed on packages of exported tobacco on a per package basis rather than quantity or value basis did not violate the Export Clause because it was compensation for services that the government rendered, and it was not excessive. The Court in United States v. U.S. Shoe Corp., 523 U.S. 360 (1998), expanded on the principles in Pace and determined that a harbor maintenance tax imposed on ships that exported products violated the Export Clause. The U.S. Shoe Court held that an *ad valorum* tax based on the value of the cargo imposed on ships using the harbor "does not correlate reliably with the federal harbor services used or useable by the exporter." Id. at 369.

In the case at issue here, using Pace and U.S. Shoe as guides, the district court fashioned a two-part inquiry to determine whether a charge is an impermissible tax or a valid user fee: (1) whether the charge is determined based on its proportion to the quantity or value of the package; and (2) whether the charge is excessive or fairly matches the exporter's use of the services provided by the funds raised from the charge. Trafigura Trading LLC v. United States, 485 F.Supp.3d 822, 826 (S.D. Tex. 2020). The court determined that the charge was based on quantity because § 4611 imposes a tax on each barrel (defined as 42 U.S. gallons under § 4612(a)(8)). The court further determined that the charge did not fairly match the exporter's use of the services the OSLTF provided. Although there were some benefits the exporter may receive, the court pointed to a number of environmental projects the OSLTF supports including assessing natural resource damage and implementing plans to restore

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damaged resources, research and development of oil spill technology, studying the effects of pollution, and other similar projects. The court found that these broad uses of OSLTF funds meant that the charge was not closely matched to a government service that justified a per-barrel fee. The court pointed to factors that affected the cost of oil spill clean-up and suggested that Congress could have taken some of these factors into account to fashion a valid user fee under Pace and U.S. Shoe. Id. at 829. The court stated that the biggest problem it saw, however, was the tax equally applied to product exported by truck from North Dakota to Canada as it did to product exported by ship. The potential benefits provided by the OSLTF would not apply to land-based transportation so that the taxpayer received no benefit for its payment for those oil exports. The court stated this had the effect of land-locked states subsidizing port access states and that effect violated the intent of the Export Clause, which was to prevent Congress from raising a disproportionate amount of federal revenue from southern states. The court found this one issue dispositive. Id.

The Service disagreed with the district court and appealed to the U.S. Court of Appeals for the Fifth Circuit, arguing that § 4611(b) operates to defray the cost of the Government's effort to insure against the risk of oil spills and as a mandated insurance premium for risk pooling by the oil industry as a whole. The appellate court affirmed the district court, holding that § 4611(b) imposes a tax on exports in violation of the Export Clause. See Trafigura Trading LLC v. United States, 29 F.4th 286 (5th Cir. 2022). The government filed a petition for rehearing en banc, arguing that the court's rationale for overturning a statute was flawed because Congress has the right to impose a user fee to recoup the costs associated with oil spills for risks created by the oil industry and that a per barrel fee was similar to the permissible user fee described in Pace. The Fifth Circuit rejected the Service's request for a rehearing en banc.

The ruling that § 4611(b) is unconstitutional allows exporters to avoid their share of a fee system that Congress imposed on all refiners, importers, and exporters to cover the environmental risk that their product poses to the public. In addition, the Fifth Circuit wrongly adopted the district court's two-part test to determine whether a charge is a tax or a user fee. The Fifth Circuit gives too much weight to a quantitative determination that, in fact, ties closely with the amount of government services provided to fund the OSLTF. The Service disagrees with the Fifth Circuit, both for its conclusion that the fee is not fairly matched to the benefits received but also for the use of a two-part test to determine that a charge based on quantity is automatically more like a tax than a user fee. Nonetheless, in the interest of sound tax administration, the Service will follow the decision in all circuits.

Therefore, the Service will no longer seek to collect the tax imposed by § 4611(b)(1)(A) on domestic crude oil that is exported. Additionally, if the Service previously denied a taxpayer's refund claim for the tax imposed by § 4611(b)(1)(A) for exported domestic

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crude oil because the tax is unconstitutional, the taxpayer may file for audit reconsideration for any year that is still open under § 6532(a).

Recommendation: Acquiescence

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