No. _____

In the

Supreme Court of the United States

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WISCONSIN DEPARTMENT OF REVENUE, et al.,

Petitioners,

v.

UNION PACIFIC RAILROAD COMPANY,

Respondent.

———— ♦ ————

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Seventh Circuit

———— ♦ ————

PETITION FOR WRIT OF CERTIORARI

———— ♦ ————

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QUESTION PRESENTED

The Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act"), codified at 49 U.S.C. § 11501, limits state taxation of railroads in several ways. Subsections (b)(1)–(3) provide specific rules for state property taxes, requiring States to apply the same assessment ratio and tax rate to railroads that they apply to commercial and industrial property owners. 49 U.S.C. § 11501(b)(1)–(3). Subsection (b)(4) then prohibits States from "[i]mpos[ing] another tax that discriminates against [railroads]." 49 U.S.C. § 11501(b)(4).

In *Department of Revenue of Oregon v. ACF Industries, Inc.*, 510 U.S. 332, 347–48 (1994), the Court held that the 4-R Act "does not limit the States' discretion to exempt nonrailroad property, but not railroad property, from ad valorem property taxes of general application." The Court left open the question of whether a State would violate subsection (b)(4) if "railroads—either alone or as part of some isolated and targeted group—are the only commercial entities subject to an ad valorem property tax." *Id.* at 346. The question presented is:

Does a State violate subsection (b)(4) by exempting intangible personal property of non-railroads from its personal property tax, but not exempting such property for a limited group of taxpayers that includes railroads?

PARTIES TO THE PROCEEDING

There are no parties to this proceeding other than the named parties: the Wisconsin Department of Revenue, its Secretary Peter Barca, sued in his official capacity, and Union Pacific Railroad Company.

STATEMENT OF RELATED CASES

Union Pacific Railroad Co. v. Wisconsin Dep't of Revenue, No. 17-cv-897-wmc, U.S. District Court for the Western District of Wisconsin. Judgment entered March 22, 2019.

Union Pacific Railroad Co. v. Wisconsin Dep't of Revenue, No. 19-1741, U.S. Court of Appeals for the Seventh Circuit. Judgment entered October 7, 2019.

TABLE OF CONTENTS

INDEX TO APPENDIX

TABLE OF AUTHORITIES

Other Authorities

PETITION FOR A WRIT OF CERTIORARI

The Wisconsin Department of Revenue and its Secretary, Peter Barca, respectfully petition this Court for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The Seventh Circuit's opinion is reported as *Union Pacific Railroad Co. v. Wisconsin Department of Revenue*, 940 F.3d 336 (7th Cir. 2019), and reproduced at App. A:1a–11a. The District Court's opinion is reported as *Union Pacific Railroad Co. v. Wisconsin Department of Revenue*, 360 F. Supp. 3d 861 (W.D. Wis. 2019), and reproduced at App. B:12a–29a.

JURISDICTION

The judgment of the court of appeals was entered on October 7, 2019. On December 20, 2019, Justice Kavanaugh extended the time within which to file a petition for a writ of certiorari to and including January 27, 2020. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

The Railroad Revitalization and Regulatory Reform Act of 1976 provides in relevant part:

49 U.S.C. §11501. Tax discrimination against rail transportation property.

(a) In this section—

(1) the term "assessment" means valuation for a property tax levied by a taxing district;

(2) the term "assessment jurisdiction" means a geographical area in a State used in determining the assessed value of property for ad valorem taxation;

(3) the term "rail transportation property" means property, as defined by the Board, owned or used by a rail carrier providing transportation subject to the jurisdiction of the Board under this part; and

(4) the term "commercial and industrial property" means property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy.

(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:

(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.

INTRODUCTION

This case presents the issue the Court left open in *ACF Industries*. In that case, the Court held that "a State may grant exemptions from a generally applicable ad valorem property tax without exposing the taxation of railroad property to invalidation under subsection (b)(4)." *ACF Industries*, 510 U.S. at 340. The Court, however, noted that the case was not one "in which the railroads—either alone or as part of some isolated and targeted group—are the only commercial entities subject to an ad valorem property tax." *Id.* at 346. As a result, the Court did not need to "decide whether subsection (b)(4) would prohibit a tax of that nature." *Id.*

The Seventh Circuit held, contrary to *ACF Industries*, that Wisconsin violated subsection (b)(4) by exempting a class of property—intangible personal property, specifically custom computer software—for commercial and industrial property owners that it did not exempt for railroads. Wisconsin imposes a personal property tax on commercial and industrial property owners that exempts intangible personal property. Wisconsin also imposes a personal property tax on railroads and other utilities that does not exempt intangible personal property. Wisconsin therefore falls within the general rule in *ACF Industries* that subsection (b)(4) does not prohibit a state from granting exemptions to nonrailroads.

The Seventh Circuit and other lower courts have misread the caveat to *ACF Industries*' holding. The Court left open whether a State would violate

subsection (b)(4) if railroads, either alone or as part of an isolated group, were the only entities to pay property tax at all. The exception did not cover instances in which railroads were the only entities, or part of an isolated group, that paid tax on a certain class of property. That reading conflicts with the central holding of the case—that States can exempt nonrailroad property without violating the 4-R Act. Highlighting this point, Justice Stevens in dissent understood the majority's possible exception applied to a tax scheme that exempted "100 percent of nonrailroad property." *ACF Industries,* 510 U.S at 354 (Stevens, J., dissenting).

The Seventh Circuit's interpretation of the exception to *ACF Industries* conflicts with the text and structure of the 4-R Act. Subsections (b)(1)–(3) require that States impose the same assessment ratio and tax rate to "rail transportation property" that they apply to "commercial and industrial property." 49 U.S.C. § 11501(b)(1)–(3). While "rail transportation property" includes all railroad property, Congress defined "commercial and industrial property" to "exclude[] property that is exempt." *ACF Indus.*, 510 U.S. at 343. And because Congress allowed States to exempt commercial and industrial property in subsections (b)(1)–(3), subsection (b)(4) could not be read to prohibit that very thing. *Id.* As a result, "subsection (b)(4) does not limit state discretion to levy a tax upon railroad property while exempting various classes of nonrailroad property." *Id.* Under the Seventh Circuit's reasoning, however, States lose the

discretion to grant exemptions to nonrailroads when railroads own that class of property. In that case, States must grant the same exemption to railroads that they grant to the comparison class. This, in conflict with *ACF Industries*, interprets subsection (b)(4) to prohibit what subsections (b)(1)–(3) allow.

This issue is of great importance. The lower courts' expansive reading of subsection (b)(4) impinges on state taxation of property, which is "central to state sovereignty." *ACF Indus.*, 510 U.S. at 345. These courts have ignored the rule that "[w]hen determining the breadth of a federal statute that impinges upon or pre-empts the States' traditional powers," the statute should not be extended "beyond its evident scope." *Id.* This case involves about $2 million in tax revenue for one railroad over just two years in one State. When one considers the number of railroads and the number of States this could affect, and that the issue will recur year after year, the total amount of tax revenue at stake is very large. The Court should grant certiorari to keep the federal intrusion on state sovereignty within the 4-R Act's evident scope. Failure to do so will result in States losing a core part of their traditional powers based on an incorrect reading of the 4-R Act and millions of dollars in lost property tax revenue.

STATEMENT OF THE CASE

I. The 4-R Act

The 4-R Act prohibits States and their subdivisions from taking certain actions when taxing railroads that "unreasonably burden and discriminate against interstate commerce." 49 U.S.C. § 11501(b). Subsections (b)(1)–(3) set out specific requirements for state property taxation of railroads. Under subsections (b)(1)–(2), a State cannot "[a]ssess 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," 49 U.S.C. § 11501(b)(1), and cannot levy or collect a tax on such an assessment, 49 U.S.C. § 11501(b)(2). Subsection (b)(3) prohibits a State from taxing "rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction." 49 U.S.C. § 11501(b)(3).

The 4-R Act defines "rail transportation property" as "property, as defined by the [Surface Transportation] Board, owned or used by a rail carrier." 49 U.S.C. § 11501(a)(3). The Act defines "commercial and industrial property" as "property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy." 49 U.S.C. § 11501(a)(4). *ACF Industries* noted that "Congress qualified the definition of 'commercial and industrial

property' [by] limiting the comparison class to property 'subject to a property tax levy.'" 510 U.S. at 340 (quoting 49 U.S.C. § 11501(a)(4)). The Court determined that "property 'subject to a property tax levy' means property that is taxed." *Id.* at 342. Consequently, exempt property, because it is not taxed, "is not part of the comparison class against which discrimination is measured under subsections (b)(1)–(3)." *Id.* at 342. As a result, "railroads may not challenge property tax exemptions under those provisions." *Id.*

Subsection (b)(4), in contrast, prohibits a State from "[i]mpos[ing] *another tax* that discriminates against a rail carrier." 49 U.S.C. § 11501(b)(4) (emphasis added). *ACF Industries* held that "[t]he interplay between subsections (b)(1)–(3) and the definition of 'commercial and industrial property' in subsection (a)(4) is central to the interpretation of subsection (b)(4)." 510 U.S. at 340. By choosing a definition of "commercial and industrial property" that covered only taxed property, "Congress placed exempt property beyond the reach of subsections (b)(1)–(3)." *Id.* at 343. Therefore, "[i]t would be illogical to conclude that Congress, having allowed the States to grant property tax exemptions in subsections (b)(1)–(3), would turn around and nullify its own choice in subsection (b)(4)." *Id.* As a result, "subsection (b)(4) does not limit state discretion to levy a tax upon railroad property while exempting various classes of nonrailroad property." *Id.*

In addressing an argument advanced by the carlines that the Court's interpretation prohibited mild discrimination but allowed it in the extreme, the Court noted that "this is not a case in which the railroads—either alone or as part of some isolated and targeted group—are the only commercial entities subject to an ad valorem property tax." *Id.* at 346. Because "Oregon's ad valorem property tax does not single out railroad property in that manner," the Court "need not decide whether subsection (b)(4) would prohibit a tax of that nature." *Id.* at 347.

II. Wisconsin's property tax system

There are two chapters of the Wisconsin Statutes relevant to this case. Chapter 70 imposes a general property tax on commercial and manufacturing property owners—the comparison class to railroads under subsections (b)(1)–(3). Railroads are taxed as utilities under chapter 76.

A. Chapter 70 property taxation

Wisconsin imposes a general property tax in chapter 70 of the Wisconsin Statutes, titled "General Property Taxes," which covers commercial and industrial property owners, among others. Most property is assessed at the local level, Wis. Stat. § 70.05, while manufacturing property is assessed centrally by the Wisconsin Department of Revenue (the "Department"). Wis. Stat. § 70.995.

The tax is imposed "upon all general property in this state except property that is exempt from taxation." Wis. Stat. § 70.01. In turn, general property is defined as "all the taxable real and personal property defined in ss. 70.03 and 70.04." Wis. Stat. § 70.02. Real property is defined as "land" as well as "all buildings and improvements thereon, and all fixtures and rights and privileges appertaining thereto." Wis. Stat. § 70.03(1). Personal property includes, among other things, "[a]ll goods, wares, merchandise, chattels, and effects, of any nature or description, having any real and marketable value" that are not defined as real property. Wis. Stat. § 70.04(1g).

There are numerous exemptions from chapter 70's general property tax. *See* Wis. Stat. §§ 70.11(1)–(46), 70.111(1)–(27), 70.112(1), (4)–(7). Most pertinent here is the exemption for "[m]oney and all intangible personal property." Wis. Stat. § 70.112(1). Because custom software is considered intangible personal property, commercial and industrial property owners do not pay tax on the value of their custom software.

B. Chapter 76 property taxation

Chapter 76 of the Wisconsin Statutes governs taxation of utilities, including railroads, air carriers, pipeline companies, and water conservation companies. Wis. Stat. § 76.01. Utilities are assessed by the Department. *Id.* A railroad's taxable property includes "all franchises, and all real and personal property of the company used or employed in the operation of its business." Wis. Stat. § 76.025(1).

Railroads do not receive the exemption for intangible personal property, only receiving four exemptions not relevant here.

All railroad property, "both real and personal," is "deemed personal property for the purpose of taxation, and shall be valued and assessed together as a unit." Wis. Stat. § 76.03(1). The Department produces one value for all of the railroad's property nationwide. (Dkt. 50 ¶ 7.) That value is then apportioned to Wisconsin by a statutory formula. Wis. Stat. § 76.07(4g)(a).

III. Facts

A. Taxation of Union Pacific's custom software

For many years, Union Pacific claimed the value of its custom software as exempt from property taxation even though it is not exempt under Wisconsin law. (Dkt. 26 ¶ 20.) This allowed Union Pacific to subtract the value it attributed to its custom software from its assessed value.

For 2014, Union Pacific claimed a total value of its custom software of just over $5 billion (Dkt. 30-11:2–3), with just under $38 million apportioned to Wisconsin (Dkt. 26 ¶ 27). For 2015, Union Pacific claimed a total value of $6.2 billion (Dkt. 30-11:2), with about $58 million apportioned to Wisconsin (Dkt. 26 ¶ 27).

In 2016 and 2017, the Department audited Union Pacific's 2014 and 2015 tax returns. (Dkt. 26 ¶ 23.) The Department disallowed Union Pacific's exemption for its custom software, resulting in $802,097.44 in additional tax for 2014 and $1,162,904.95 in additional tax for 2015. (Dkt. 27:1–3.) Including interest, Union Pacific owed a total of $2,631,104.77. (Dkt. 26 ¶ 29.)

B. Taxation of railroads compared to commercial and industrial property owners.

Railroads pay a small percentage of Wisconsin's property tax collections, whether one looks at real and personal combined or only personal property. In 2015, Wisconsin's total property tax levy was $9.4 billion. (Dkt. 30-10:8.) Commercial property owners and manufacturers paid $2.6 billion in property tax, with $262 million on personal property. (Dkt. 30-10:8.) Railroads paid $36.8 million in property tax on real and personal property combined. (Dkt. 46 ¶ 2.) Given the way railroads are assessed, the railroads' taxes cannot be attributed to real or personal property. But under any view, railroads' share of the Wisconsin property tax levy is small.

IV. Litigation history

On November 27, 2017, Union Pacific filed a complaint alleging a violation of 49 U.S.C. § 11501(b)(4) and seeking declaratory and injunctive relief against the Department and the Secretary of Revenue (collectively "Wisconsin"). (Dkt. 1.) Union

Pacific claimed that Wisconsin violated subsection (b)(4) because "[t]he imposition of a property tax on the value of UP's intangible custom computer software, where the custom computer software of other commercial and industrial taxpayers in Wisconsin is not taxed, results in discriminatory treatment of a common carrier by rail." (Dkt. 13 ¶ 21.)

Both parties filed for summary judgment. Union Pacific contended that the case fell within the exception in *ACF Industries*, while Wisconsin argued that it, under the general rule in *ACF Industries*, had discretion to grant an exemption to non-railroads while taxing railroads.

The district court granted summary judgment to Union Pacific, holding that it satisfied the exception to the general rule in *ACF Industries*. (Dkt. 53, App. B) The court, relying on decisions from other circuits, held that because railroads are among "the only entities in Wisconsin who are taxed for their intangible personal property -- including custom computer software," the tax on intangible personal property "is *not* one of general applicability, but rather is one that appears to fall squarely, if not entirely, on railroads 'as part of some isolated and targeted group.'" (Dkt. 53:12, App. B:26a (quoting *ACF Indus.*, 510 U.S. at 346).) It then entered a permanent injunction prohibiting Wisconsin from assessing, levying or collecting property taxes on the value of Union Pacific's custom software. (Dkt. 55.)

The Seventh Circuit affirmed, similarly holding that Union Pacific's challenge fell within the exception in *ACF Industries*. The court followed decisions from the Eighth and Tenth Circuits which held that subsection (b)(4) prevented States from taxing intangible personal property of railroads if they did not tax that property for commercial and industrial taxpayers. *Union Pacific*, 940 F.3d at 340, App. A:7a–8a (citing *Burlington N. R.R. Co. v. Huddleston*, 94 F.3d 1413 (10th Cir 1996); *Burlington N. R.R. Co. v. Bair*, 60 F.3d 410, 413 (8th Cir. 1995)). The court reasoned that *ACF Industries* did not apply because "the challenge is to the same class of property being taxed differently based on the owner's membership in a targeted and isolated group." *Id.*, App. A:9a. The court held that Wisconsin violated subsection (b)(4) because it "systematically exempts from its intangible property tax all manufacturing and commercial taxpayers except for railroad and utilities companies." *Id.* at 341, App. A:10a.

REASONS FOR GRANTING THE PETITION

This case allows the Court to clarify the question it left open in *ACF Industries*: to what extent does subsection (b)(4) apply to state property tax exemptions. The Court should decide that subsection (b)(4) does not prohibit a State from imposing a personal property tax on railroads as well as commercial and industrial property owners, while exempting a class of property for commercial and industrial taxpayers that it does not exempt for railroads.

The Seventh Circuit "decided an important question of federal law that has not been, but should be, settled by this Court." Sup. Ct. R. 10(c). It and other lower courts have extended subsection (b)(4) beyond the statute's evident scope to infringe on state taxation, one of the most important aspects of state sovereignty. The Court should limit the intrusion on state sovereignty to that supported by the plain language and structure of the 4-R Act. Wisconsin's property tax system satisfies the specific requirements for property taxes imposed in subsections (b)(1)–(3). As *ACF Industries* held, subsection (b)(4) should not be used to invalidate property tax systems that satisfy subsections (b)(1)–(3). This is case is important because it involves potentially millions of dollars in state tax revenues in States around the country.

I. The Seventh Circuit's decision directly conflicts with *ACF Industries*' interpretation of the 4-R Act.

The Seventh Circuit's decision in this case conflicts with *ACF Industries*, which held, based on the structure of the 4-R Act, that subsection (b)(4) does not apply to property tax exemptions. While *ACF Industries* left open the possibility that a railroad might be able to challenge a property tax if railroads, either alone or part of an isolated group, were the only commercial entities subject to an ad valorem property tax, that does not apply here. In Wisconsin, railroads and commercial and industrial property owners are all subject to a personal property tax. The Seventh Circuit, and other lower courts, have mistakenly held

that subsection (b)(4) applies when railroads are among a limited group to pay property tax on a particular class of property because that class is exempt for commercial and industrial taxpayers. Congress imposed specific requirements for property taxes in subsections (b)(1)–(3) that sufficiently protect railroads. Subsection (b)(4) was intended to address other, different taxes a State might impose.

A. *ACF Industries* held that claims related to property tax exemptions are not cognizable under the 4-R Act.

The Seventh Circuit's decision conflicts with the text and structure of the 4-R Act. *ACF Industries* held that "[t]he structure of § [11501] . . . warrants the conclusion that subsection (b)(4) does not limit state discretion to levy a tax upon railroad property while exempting various classes of nonrailroad property." *ACF Indus.*, 510 U.S. at 343. As a result, subsection (b)(4) does not prohibit a State from taxing a class of property owned by a railroad—here intangible personal property—while exempting that class of property for commercial and industrial taxpayers The Seventh Circuit, in conflict with *ACF Industries*, erroneously held that the 4-R Act limits state discretion to exempt nonrailroad property when a railroad owns that class of property.

The holding in *ACF Industries* was based on a careful analysis of the 4-R Act's structure, specifically "[t]he interplay between subsections (b)(1)–(3) and the definition of 'commercial and industrial property'

in subsection (a)(4)." *Id.* at 340. As an initial matter, the Court noted that Congress excluded agricultural land from the definition of "commercial and industrial property," thus "demonstrat[ing] its intent to permit the States to tax railroad property at a higher rate than agricultural land, notwithstanding subsection (b)(3)'s general prohibition of rate discrimination." *Id.* While imposing a higher rate on railroad property than agricultural property could be "considered 'another tax that discriminates against a rail carrier,' and thus forbidden under subsection (b)(4)," such an "interpretation . . . would subvert the statutory plan by reading subsection (b)(4) to prohibit what subsection (b)(3), in conjunction with subsection (a)(4), was designed to allow." *Id.*

The Court then used the same logic to decide that States could exempt nonrailroad property without violating subsection (b)(4). The specific prohibitions in subsections (b)(1)–(3) require the same tax rates and assessment ratios for "rail transportation property" and "commercial and industrial property." While "rail transportation property" includes all railroad property, "commercial and industrial property" is defined as "property . . . devoted to a commercial or industrial use and subject to a property tax levy." 49 U.S.C. § 11501(a)(4). The phrase "subject to a property tax levy" means "property that is taxed." *ACF Indus.*, 510 U.S. at 342. "As was the case with agricultural land," the Court needed to "pay heed to the fact that Congress placed exempt property beyond the reach of subsections (b)(1)–(3)." *Id.* at 343. Given this structure, "[i]t would be illogical to conclude that

Congress, having allowed the States to grant property tax exemptions in subsections (b)(1)–(3), would turn around and nullify its own choice in subsection (b)(4)." *Id.* Therefore, "[t]he structure of § 11503 . . . warrants the conclusion that subsection (b)(4) does not limit state discretion to levy a tax upon railroad property while exempting various classes of nonrailroad property." *Id.*

Under that same reasoning, subsection (b)(4) does not apply in this case. Union Pacific's claim centers on a class of property owned by commercial and industrial taxpayers that Wisconsin does not tax. But the 4-R Act's structure shows that Congress was not concerned about such untaxed property. Congress put "exempt property beyond the reach of subsections (b)(1)–(3)," and, because subsection (b)(4) should not be read to disallow what subsections (b)(1)–(3) allow, it is also beyond the reach of subsection (b)(4). *ACF Indus.*, 510 U.S. at 343. Union Pacific only filed its claim under subsection (b)(4) because Wisconsin's tax system does not violate subsections (b)(1)–(3).

B. This case does not meet the test in *ACF Industries* for when subsection (b)(4) might apply to tax exemptions.

The lower court rulings are based on a misunderstanding of a caveat to the holding in *ACF Industries*. After explaining its reasoning, the Court addressed some contrary arguments raised by the plaintiff carlines. The carlines argued "that it would be nonsensical for Congress to prohibit the States from imposing higher tax rates or assessment ratios

upon railroad property than upon other taxed property, while at the same time permitting the States to exempt some or all classes of nonrailroad property altogether." *ACF Indus.*, 510 U.S. at 346. They contended that the Court's interpretation "prohibits discrimination of a mild form, but permits it in the extreme." *Id.* The Court responded by noting "this is not a case in which the railroads—either alone or as part of some isolated or targeted group—are the only commercial entities subject to an ad valorem property tax." *Id.* at 346. Because the Oregon tax at issue did not do that, the Court "need not decide whether subsection (b)(4) would prohibit a tax of that nature." *Id.* at 347.

The Court, in discussing this possible exception to its holding, did not intend to foreclose States from granting tax exemptions to nonrailroads if railroads owned that class of property. It mentioned the possible exception to its general rule while rejecting the carlines' argument that subsection (b)(4) should not allow "States to exempt some or all classes of nonrailroad property altogether." *Id.* at 346. Further, the Court explained that if railroads were the only commercial entities to pay an ad valorem property tax, "it might be incorrect to say that the State 'exempted' the nontaxed property. Rather, one could say that the State had singled out railroad property for discriminatory treatment." *Id.* at 346–47. For support, the Court cited a treatise for the proposition that an "exemption" from a tax meant "exclusion[] of 'property, persons, transactions . . . which are logically within the tax base.'" *Id.* at 347 (quoting J.

Hellerstein & W. Hellerstein, State and Local Taxation 973 (5th ed. 1988)). The possible exception was intended to cover situations in which States were not truly exempting a class of property that was within the tax base, but imposing a tax only on railroads (or an isolated group).

As the Court's discussion makes plain, subsection (b)(4) might apply when railroads, either alone or part of an isolated group, are the only entities to pay *an ad valorem property tax*. As Justice Stevens noted in dissent, the majority was discussing a tax scheme that exempted "100 percent of nonrailroad property." *Id.* at 354 (Stevens, J., dissenting). Notably, the case itself involved a State that exempted somewhere between 25% and 32% of all nonrailroad property. *ACF Industries*, 510 U.S. at 337–38. The Court certainly did not intend its statement to apply to cover instances in which a State exempted one class of property for nonrailroads but not railroads. The Seventh Circuit's interpretation of the potential caveat to *ACF Industries* undermines the case's holding.

Under a proper understanding of the potential exception discussed in *ACF Industries*, Wisconsin does not violate subsection (b)(4). Railroads, either alone or as part of the group of public utilities, are not the only commercial property owners subject to an ad valorem property tax; instead, they are not entitled to an exemption on one class of property. Manufacturers and commercial property owners are subject to an ad valorem tax on both their real property and personal

property. Wis. Stat. §§ 70.01–70.04. Railroads are also subject to a tax on their real and personal property. Wis. Stat. § 76.025(1). Those commercial and industrial taxpayers pay significant amounts in both total property taxes and personal property taxes. (Dkt. 30-10:8.) They do not pay tax on their custom software because of the exemption for intangible personal property in Wis. Stat. § 70.112(1). Railroads pay tax on their custom software because they do not receive the exemption in Wis. Stat. § 70.112(1). And because intangible personal property is merely a class of personal property, it is logically within the personal property tax base and can be exempted consistent with the 4-R Act. As a result, this case does not involve the type of taxation scheme discussed in *ACF Industries*.

C. The Seventh Circuit and other lower courts have misinterpreted *ACF Industries* as preventing States from granting exemptions for intangible personal property.

This Court should clarify the issue it raised, but did not decide, in *ACF Industries*: when does subsection (b)(4) apply to property tax exemptions? Specifically, this Court should decide what qualifies as a tax system "in which the railroads—either alone or as part of some isolated and targeted group—are the only commercial entities subject to an ad valorem property tax." *ACF Indus.*, 510 U.S. at 346. The courts of appeal have granted railroads protection from state taxation not provided by the 4-R Act. This Court should decide the case to determine the proper scope

of subsection (b)(4) so that the 4-R Act's intrusion on state sovereignty is limited to the statute's plain terms.

The Seventh Circuit erred in applying the exception when a narrow group of utilities, including railroads, are the only commercial entities to pay property tax *on a particular class of property*. The Seventh Circuit followed two other circuits in holding that a State violates subsection (b)(4) by taxing railroads' intangible personal property while exempting the intangible personal property of commercial and industrial taxpayers. *Union Pacific*, 940 F.3d at 340–41, App. A:7a–8a; *Huddleston*, 94 F.3d at 1416–17; *Bair*, 60 F.3d at 412–13. The Tenth Circuit even misread the exception as applying to "state tax 'exemptions' denied to an 'isolated and targeted group.'" *Huddleston*, 94 F.3d at 1417. *ACF Industries* did not discuss exemptions denied to a targeted group, but a tax imposed on that targeted group. As discussed above, the courts' broad reading of the exception to *ACF Industries* is contrary to the text and structure of the 4-R and the decision's reasoning.

Further, the Seventh Circuit incorrectly focused on this Court's phrase that subsection (b)(4) "does not limit the States' discretion to exempt nonrailroad property, but not railroad property, from ad valorem property taxes *of general application*." *ACF Industries*, 510 U.S. at 347–48 (emphasis added). It held that Wisconsin did not impose a generally applicable property tax on intangible personal

property because such property was not taxed for commercial and industrial taxpayers. *Union Pacific*, 940 F.3d at 340, App. B:17a–18a. This analysis, however, is contrary to *ACF Industries*, which held that States may grant exemptions to railroads without violating the 4-R Act. An exemption granted to nonrailroads, but not railroads, for a certain class of property can always be characterized as a targeted tax on railroads for that same class of property. Under the Seventh Circuit's reasoning, a State would violate subsection (b)(4) in all such instances because exempting a class of property meant that the State did not impose a generally applicable tax on that class of property. The Seventh Circuit's approach would allow the exception to swallow the rule.

D. Congress made a reasonable choice in the property tax protections it provided to railroads.

The decisions on which the Seventh Circuit relied are based on a misunderstanding of how state property taxes work. The Tenth Circuit hypothesized that if subsection (b)(4) did not apply to property taxes, then "states could circumvent § 306 simply by enacting a tax of 'general application,' and then 'exempting' from the tax all but a certain class of taxpayers." *Huddleston*, 94 F.3d at 1417. Similarly, the Eighth Circuit said that "the anti-discrimination purpose of the 4–R Act could utterly be eviscerated by a state that ostensibly imposed a tax of general applicability but then systematically exempted all but a targeted few taxpayers." *Bair*, 60 F.3d at 413. This is not a realistic possibility, however, because

States collect much more in property taxes from non-railroads than railroads—in Wisconsin, it is $2.6 billion for commercial and industrial taxpayers compared to $36.8 million for railroads. (Dkt. 30-10:8.) While a State might exempt certain classes of non-railroad property, they cannot exempt all non-railroad property without decimating their revenue. Courts do not need to read the 4-R Act to avoid this unrealistic hypothetical.

Congress, in contrast, surely understood the nature of state property taxation when drafting the 4-R Act. It could have reasonably thought railroads would be adequately protected by tying their taxation to that of local businesses. States can only tax the railroad at the rate it taxes its local businesses, which Congress understood would protect railroads from onerous tax rates. And because a state must use the same assessment ratio it applies to local businesses, a state cannot apply an unrealistically high value to railroad property unless it is willing to do so to its own local taxpayers. Again, Congress surely understood this would not happen.

The 4-R Act sets a ceiling for railroad property taxes. States can only tax all of a railroad's property (*i.e.*, no exemptions) using the assessment ratio and tax rate applied to local businesses. When states exempt nonrailroad property, this system does result in railroads paying a higher percentage of their total property value in taxes compared to commercial and industrial property owners. Congress was willing to allow this to happen because it did not intend to

"protect[] rail carriers from every tax scheme that favors some nonrailroad property." *ACF Indus.*, 510 U.S. at 347. Instead, Congress used its discretion to weigh protecting railroads against preserving state tax exemptions. *Id.* Congress reasonably thought the rate and assessment ratio rules sufficiently protected railroads without the need to micromanage state tax exemptions. *Id.*

Congress's intent is shown in the text and structure of the 4-R Act. Subsections (b)(1)–(3) set forth specific requirements for property taxes. 49 U.S.C. § 11501(b)(1)–(3). In these subsections, "Congress prohibited discriminatory tax rates and assessment ratios in no uncertain terms and set forth precise standards for judicial scrutiny of challenged rate and assessment practices." *ACF Indus.*, 510 U.S. at 343 (citations omitted). Subsection (b)(4) then prohibits states from "[i]mpos[ing] another tax that discriminates against a rail carrier." 49 U.S.C. § 11501(b)(4). Subsection (b)(4) is best understood "to encompass any form of tax a State might impose, on any asset or transaction, except the taxes on property previously addressed in subsections (b)(1)-(3)." *CSX Transp., Inc. v. Ala. Dep't of Revenue*, 562 U.S. 277, 285 (2011). The Seventh Circuit, in a case *CSX* cited, said that "[s]ubsection (b)(4) is a catch-all designed to prevent the state from accomplishing the forbidden end of discriminating against railroads by substituting another type of tax. It could be an income tax, a gross-receipts tax, a use tax, an occupation tax as in this case—whatever." *Burlington N. R.R. Co. v. City of Superior,* 932 F.2d 1185, 1186 (7th Cir. 1991).

Congress outlined the only requirements for property taxes in subsections (b)(1)–(3), which it concluded adequately protected railroads. It then added subsection (b)(4) to address other, different taxes a State might impose.

If Congress truly intended the 4-R Act to require States to tax the same classes of property for railroads and nonrailroads, "it would have spoken with clarity and precision." *ACF Industries*, 510 U.S. at 344. Subsection (b)(4)'s generality contrasts with the specificity in subsections (b)(1)–(3). Congress set detailed requirements for property taxes in subsections (b)(1)–(3), which would fit any definition of "discrimination." In contrast, "the statute does not speak with any degree of particularity to the question of tax exemptions," and does "not provide a standard for courts to distinguish valid from invalid exemption schemes." *ACF Indus.*, 510 U.S. at 343. Congress set very specific standards for property taxes in subsections (b)(1)–(3) that did not prohibit exemptions for nonrailroads. Having set those specific standards for property taxes, Congress would not have intended to the phrase "another tax" to cover additional, unspecified discrimination in property taxes with no standards to judge such discrimination. Congress could easily have written the statute to require that states grant railroads all tax deductions granted to commercial and industrial property owners. Because Congress did not do so, extending subsection (b)(4) to property taxes extends the 4-R Act beyond its evident scope.

II. The question presented is an issue of national importance that merits the Court's attention.

The question presented in this case is of great importance. A State's ability to tax the property within its jurisdiction is "central to state sovereignty." *ACF Indus.*, 510 U.S. at 345. "When determining the breadth of a federal statute that impinges upon or pre-empts the States' traditional powers," the statute should not be extended "beyond its evident scope." *Id.* The Seventh Circuit, in contravention of this rule, read the 4-R Act to infringe upon a State's sovereign power beyond the evident scope of the 4-R Act. The Court should grant certiorari to determine the proper balance between state sovereignty and the scope of the 4-R Act.

The issue affects millions of dollars in state tax collections. In this case alone there was $2 million at issue for just one railroad in one State over two years. Similarly, the railroad in *Huddleston* claimed it was entitled to a $2.25 million deduction for its custom software. 94 F.3d at 1415. Including all railroads in all states, there are many millions of dollars in taxes at stake each year, which will recur every year into the future.

Moreover, the question *ACF Industries* left open is squarely presented here. Union Pacific refused to pay tax on the value of "its custom software and filed suit, arguing that the tax singles out railroads as part of an isolated and targeted group in violation of" subsection (b)(4). *Union Pacific*, 940 F.3d at 337,

App. A:2a. The Seventh Circuit held that Wisconsin violated subsection (b)(4) by "targeting railroads, either alone or as part of an isolated group." *Id.* at 341, App. A:10a. This case provides an ideal vehicle for deciding the scope of subsection (b)(4) because the case was decided on summary judgment with no disputed issues of material fact.

CONCLUSION

The Court should grant the petition for certiorari review.

Respectfully submitted,

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January 27, 2020

APPENDIX

INDEX TO APPENDIX

APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

No. 19-1741

UNION PACIFIC RAILROAD COMPANY,

Plaintiff-Appellee

v.

WISCONSIN DEPARTMENT OF REVENUE, *et al.*,

Defendants-Appellants

Appeal from the United States District Court for the Western District of Wisconsin.
No. 17-cv-00897 — **William M. Conley**, *Judge*.

ARGUED SEPTEMBER 17, 2019 —
DECIDED OCTOBER 7, 2019

Before FLAUM, ROVNER, and SCUDDER, *Circuit Judges*.

FLAUM, *Circuit Judge*. The Wisconsin Department of Revenue (the "Department") disallowed the Union Pacific Railroad Company ("Union Pacific") from claiming a property tax exemption for the value of its custom computer software, which under Wisconsin law is a type of intangible personal property. Union Pacific refused to pay the tax on its custom software and filed suit, arguing that the tax singles out railroads as part of an isolated and targeted group in violation of Section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4-R Act"), codified at 49 U.S.C. § 11501(b)(4) ("subsection (b)(4)"). The defendants contend that Wisconsin is permitted to grant non-railroads an exemption from its generally applicable ad valorem property tax scheme for intangible property, even if railroads do not qualify for the same exemption. The intangible property tax, however, exempts everyone except for an isolated and targeted group of which railroads are a part. The district court entered summary judgment for Union Pacific. We affirm.

I. Background

Chapter 70 of the Wisconsin Tax Code ("the Code") governs the taxation of manufacturing and commercial companies aside from railroad and utilities companies. Chapter 76 governs the taxation of railroad and utilities companies, including air carriers, pipeline companies, and water conservation and regulation companies. Wis. Stat. §§ 76.01–76.02. Taxpayers under chapters 70 and 76 must pay taxes on their real and personal property unless that property is exempt.

The Code contains several exemptions from the general property tax for various classes of property, including an exemption for "all intangible personal property," which covers custom computer software. Wis. Stat. § 70.112(1). Manufacturing and commercial taxpayers generally qualify for the intangible personal property exemption, but railroad and utilities companies do not. *Compare id.*, *with* Wis. Stat. § 76.025(1). The parties do not dispute that railroad and utilities companies are the only taxpayers that Wisconsin requires to pay taxes on their intangible property, including custom software.

For several years, Union Pacific claimed the value of its custom software as exempt under Wis. Stat. § 70.11(39), which applies to computers and certain types of software; however, that exemption expressly does not cover *custom* software. The Department audited Union Pacific and concluded that, for the years 2014 and 2015, it owed $2,631,104.77 in back taxes and interest after disallowing Union Pacific's deduction of its custom software. Union Pacific filed suit against the Department and its secretary,[1] contending that Wisconsin's tax on Union Pacific's custom software violates subsection (b)(4) of the 4-R Act.

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[1] Wisconsin's current Secretary of Revenue, Peter Barca, has been substituted as a defendant for his predecessor, Richard Chandler

The district court entered summary judgment for Union Pacific, concluding that because railroads are "the only entities in Wisconsin who are taxed for their intangible personal property -- including custom computer software," the tax on intangible personal property "is *not* one of general applicability, but rather is one that appears to fall squarely, if not entirely, on railroads 'as part of some isolated and targeted group.'" The defendants now appeal, arguing that Wisconsin is permitted under subsection (b)(4) to grant exemptions from its generally applicable ad valorem tax scheme, even if those same exemptions are denied to railroads.

II. Discussion

This case comes to the Court on appeal of the district court's ruling on cross-motions for summary judgment with no disputed material facts. Accordingly, we review the district court's legal conclusions de novo. *State Auto Prop. & Cas. Ins. Co. v. Brumitt Servs., Inc.*, 877 F.3d 355, 357 (7th Cir. 2017).

A. The 4-R Act

Union Pacific asserts that Wisconsin "[i]mposes another tax that discriminates against a rail carrier" in violation of 49 U.S.C. § 11501(b)(4) ("subsection (b)(4)") by taxing railroads' custom computer software while exempting custom computer software for other

taxpayers. The 4-R Act provides that states and their subdivisions may not:

> (1) [a]ssess 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) [l]evy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection[;]
>
> (3) [l]evy 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[; or]
>
> (4) [i]mpose 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). Railroads "are easy prey for State and local tax assessors in that they are nonvoting, often nonresident, targets for local taxation, who cannot easily remove themselves from

the locality." *W. Air Lines, Inc. v. Bd. of Equalization of State of S.D.*, 480 U.S. 123, 131 (1987) (citation and internal quotation marks omitted). The 4-R Act "restricts the ability of state and local governments to levy discriminatory taxes on rail carriers." *CSX Transp., Inc. v. Ala. Dep't of Revenue*, 562 U.S. 277, 280 (2011).

In *Dep't of Revenue of Or. v. ACF Indus., Inc.*, railroad car lines brought a 4-R Act challenge to Oregon's tax scheme, which exempted several classes of non-railroad property but did not exempt railroad cars. 510 U.S. 332, 335 (1994). The Supreme Court held that a tax upon railroad property is not "subject to challenge under subsection (b)(4) on the ground that certain other classes of commercial and industrial property are exempt." *Id.* at 338–39. The Court went on to explain that the case was not one

> in which the railroads—either alone or as part of some isolated and targeted group—[were] the only commercial entities subject to an ad valorem property tax.... If such a case were to arise, it might be incorrect to say that the state "exempted" the nontaxed property. Rather, one could say that the State had singled out railroad property for discriminatory treatment.

Id. at 346–47. In providing this explanation, the Court cited *Burlington N. R.R. Co. v. City of Superior*, 932 F.2d 1185 (7th Cir. 1991), as an example of a case where a rail carrier was one of the only commercial

entities singled out for discriminatory treatment. *ACF*, 510 U.S. at 346. The tax challenged in *City of Superior* was an occupational tax imposed on "owners and operators of iron ore concentrates docks." 932 F.2d at 1186 (internal quotation marks omitted). Although the tax was framed broadly, in practical effect it applied only to the one railroad company that operated the only three such docks in the state. *Id.* Because the state was "levying a tax on an activity in which, in Wisconsin anyway, only railroads engage," the iron ore docks tax could not stand. *Id.* at 1188.

The *ACF* holding does not apply, therefore, where the "actual tax levied is a general tax in name only and is in fact a tax on railroads" or a targeted group of which railroads are a part. *Burlington N. R.R. Co. v. Wis. Dep't of Revenue*, 59 F.3d 55, 58 & n.2 (7th Cir. 1995). Notwithstanding the *ACF* holding, subsection "(b)(4) might be violated if a railroad was 'singled out' for unfavorable treatment in the form of inability to benefit from property tax exemptions given to other taxpayers." *CSX Transp., Inc. v. S.C. Dep't of Revenue*, 851 F.3d 320, 331 (4th Cir. 2017). Indeed, "[t]he most obvious form of tax discrimination is to impose a tax on a class of rail transportation property that is not imposed on other nonrailroad property of the same class." *Ogilvie v. State Bd. of Equalization of State of N.D.*, 657 F.2d 204, 210 (8th Cir. 1981).

Following ACF, two of our sister circuits have held that intangible personal property taxes that were imposed on targeted and isolated groups of which

railroads were a part ran afoul of subsection (b)(4). In *Burlington N. R.R. Co. v. Huddleston*, the Tenth Circuit considered Colorado's intangible property tax exemption, concluding that "[u]nlike the tax exemption at issue in *ACF*, Colorado's intangible property tax exemption applies to *all* commercial and industrial taxpayers other than 'public utilities,'" thereby "singl[ing] out Plaintiff as part of an 'isolated and targeted group' for discriminatory tax treatment in violation of [subsection (b)(4)]." 94 F.3d 1413, 1417 (10th Cir. 1996), *abrogated in part on other grounds by Ala. Dep't of Revenue v. CSX Transp., Inc.*, 135 S. Ct. 1136, 1141 (2015). Similarly, in *Burlington N. R.R. Co. v. Bair*, the Eighth Circuit held that Iowa's intangible personal property tax violated subsection (b)(4) because it was imposed only "on railroads and a handful of other interstate concerns" and therefore was not "generally applicable." 60 F.3d 410, 413 (8th Cir. 1995).[2]

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[2] Also, a district court in Oregon recently held that Oregon's intangible personal property tax violated subsection (b)(4) because "intangible personal property [was] *not* subject to taxation *except* for property owned by" one of fourteen categories of taxpayers, including railroads. *BNSF Railway Co. v. Or. Dep't of Revenue*, 358 F. Supp. 3d 1129, 1138 (D. Or. 2018), *appeal docketed*, No. 19-35184 (9th Cir. Mar. 7, 2019). An appeal of that decision is now pending in the Ninth Circuit

B. Wisconsin's intangible Property Tax

Wisconsin's intangible personal property tax singles out railroads as part of a targeted and isolated group in violation of subsection (b)(4). What Wisconsin refers to as its "generally applicable property tax" is, functionally, generally applicable only to real and *tangible* personal property. Manufacturing and commercial companies generally must pay property taxes on the value of their real and tangible personal property. Only railroad and utilities companies, however, are required to pay an additional tax on their *intangible* property. Hence, Wisconsin does not simply exempt intangible property from taxation; rather, it imposes an intangible property tax only on railroad and utilities companies. The intangible property tax "exemption"—for which railroad and utilities companies categorically do not qualify—reflects and operates as "another tax that discriminates against a rail carrier" within the meaning of subsection (b)(4) and thereby offends the 4-R Act.

ACF does not foreclose Union Pacific's claim because the question before the Court there was "[w]hether a tax upon railroad property is even subject to challenge under subsection (b)(4) on the ground that certain *other* classes of commercial and industrial property are exempt." 510 U.S. at 338–39 (emphasis added). Here, the challenge is to the *same* class of property being taxed differently based on the owner's membership in a targeted and isolated group.

Moreover, the *ACF* holding does not apply where the "exemption" is just a pretext for targeting railroads, either alone or as part of an isolated group. "Practically speaking, if a state exempts sufficient property from a particular property tax, that tax no longer can be said to be one of general application." *Bair*, 60 F.3d at 413. Otherwise, "the anti-discrimination purpose of the 4-R Act could be utterly eviscerated by a state that ostensibly imposed a tax of general applicability but then systematically exempted all but a targeted few taxpayers." *Id.* Wisconsin systematically exempts from its intangible property tax all manufacturing and commercial taxpayers except for railroad and utilities companies.

The effect of the intangible property tax challenged here is functionally similar to that of the iron ore concentrates docks tax the Supreme Court cited in *ACF* as an example of a tax that runs afoul of subsection (b)(4), *see City of Superior*, 932 F.2d at 1188, and the taxes courts have regularly struck down under subsection (b)(4) since the *ACF* decision, *see, e.g.*, *Huddleston*, 94 F.3d at 1417; *Bair*, 60 F.3d at 413; *BNSF*, 358 F. Supp. 3d at 1138. The common defect with those taxes was that they went beyond the state's generally applicable tax by imposing an additional tax on railroads or a targeted and isolated group of which railroads were a part.

The defendants' reliance on our decision in *Burlington N. R.R. Co. v. Wis. Dep't of Revenue*, 59 F.3d 55 (7th Cir. 1995), is misplaced. In that case,

we noted that even though 80% of non-railroad property was exempt from taxation under Wisconsin's property tax scheme, railroads bore only a small proportion of the overall property tax burden. *Id.* at 57–58. Wisconsin's entire property tax scheme was therefore not a "nominally general tax which is in fact a tax only on railroads," and *ACF* precluded the plaintiff's claim that Wisconsin's taxation of railroad property altogether violated subsection (b)(4). *Id.* We did not, however, consider a challenge to the particular property tax at issue here. The question here is whether Wisconsin's intangible property tax singles out railroads as part of a targeted and isolated group in violation of subsection (b)(4). We hold that it does.

"It is now well established that a showing that the railroads have been targeted is enough to prove discrimination." *Kan. City S. Railway Co. v. Koeller*, 653 F.3d 496, 510 (7th Cir. 2011). The defendants have not provided a non-discriminatory justification for imposing a targeted tax on the intangible property of railroad and utilities companies, nor have they contested the district court's conclusion that the railroad and utilities companies as defined in the Code are a targeted and isolated group.

II. Conclusion

For the foregoing reasons, we AFFIRM the judgment of the district court.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF
WISCONSIN

UNION PACIFIC RAILROAD COMPANY,

Plaintiff,

v.

OPINION AND ORDER
17-cv-897-wmc

WISCONSIN DEPARTMENT OF
REVENUE and RICHARD G. CHANDLER,
Secretary of Revenue,

Defendants.

Plaintiff Union Pacific Railroad Company ("Union Pacific") filed suit against the Wisconsin Department of Revenue ("DOR") and its secretary, Richard Chandler, seeking injunctive and declaratory relief concerning adjustments to its 2014 and 2015 tax returns totaling $2,631,104.77 in principal and interest. At the end of February 2018, the parties stipulated to and this court entered an order preserving the status quo, directing defendants not to: (1) "collect the disputed taxes"; (2) "take any of the actions authorized for delinquent taxes" under Wisconsin law; or (3) "initiate any actions to record or enforce a lien upon any property of [plaintiff] for the disputed taxes." (Feb. 27, 2018 Order (dkt. #21) 1.)

Before the court are the parties' cross-motions for summary judgment. (Dkt. ##24, 33.) For the reasons detailed below, plaintiff's motion is granted and defendant's is denied.

UNDISPUTED FACTS[1]

A. Background

Chapter 70 of the Wisconsin Statutes contains the state's general property tax statutes, including those governing industrial and commercial taxpayers. Taxes authorized by Chapter 70 are based on property assessments performed by local assessors, except for manufacturing properties which are assessed by DOR. The Wisconsin Legislative Fiscal Bureau ("LFB"), a nonpartisan entity that provides fiscal and program information and analysis to the Wisconsin Legislature, issued Informational Paper 13 in January 2017 about Wisconsin's Property Tax Level.

As set forth in the chart below, the total property tax levy for 2015 in Wisconsin was $9.4 billion, of which $2.6 billion was against industrial and commercial properties. Of that latter amount, roughly 10% was for personal property.

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[1] The following facts are material and undisputed for purposes of summary judgment, except where noted below.

Type of Taxpayer	Total Property Tax Levied	Tax Levied on Personal Property
Commercial Property Owners	$2.2 billion	$197 million
Manufacturers	$363 million	$65 million
Total:	$2.6 billion	$262 million

In contrast, as defined in Wis. Stat. § 70.11(39), "intangible personal property" is exempt from the state's general property taxation provisions. Since the 1999-2000 Wisconsin Legislative session, one recognized type of exempt, intangible personal property has been "custom computer software," which refers to software that was internally developed, owned, and operated by the taxpayer. The Wisconsin Legislative Fiscal Bureau opines that "[c]ustom software is exempt as an intangible under s. 70.112(1) of the statutes." (LFB Paper #1043 (dkt. #30-3) 1.) Union Pacific agrees that LFB Paper #1043 includes that statement, but notes that the statement is only "the author's non-authoritative interpretation of the law." (Pl.'s Resp. to Defs.' PFOF (dkt. #38) ¶ 3.)

B. DOR's Audit of Union Pacific

Union Pacific is a Delaware corporation with its principal place of business in Omaha, Nebraska. As a common carrier engaged in interstate commerce by rail, Union Pacific operates in Wisconsin, among numerous other states. Under Subchapter I of Chapter 76 of the Wisconsin Statutes, the DOR is

authorized to assess railroad property and collect property taxes. The following chart sets forth the amounts of annual property taxes levied against all railroads in Wisconsin from 2012 to 2017:

Year	Levy
2012	$28,390,765.12
2013	$31,318,995.78
2014	$33,903,738.10
2015	$36,782,519.23
2016	$41,731,761.65
2017	$43,602,821.87

Subchapter I also provides for the assessment and taxation of other "utilities," including "all conservation and regulation companies," "all air carriers," and "all pipeline companies." Wis. Stat. § 76.01.

Since at least the 2006 tax year, Union Pacific has reported its custom computer software as exempt property in its filings with DOR. Union Pacific also provided DOR with a copy of a fair market appraisal of its custom computer software. That appraisal was performed by Robert Reilly, an expert in valuing intangible assets, who assigned a total value of

Union Pacific's custom software at just over $5 billion for 2014 and at $6.2 billion for 2015.

In 2016 and 2017, DOR conducted its own audit of Union Pacific's property tax assessment for tax years 2014 and 2015. Following that audit, DOR issued an "Omitted Property Assessment Notice" on September 6, 2017, asserting that Union Pacific owed an additional $2,631,104.77 in taxes and interest for the combined years 2014 and 2015, based on an adjustment required to "add back property incorrectly claimed as exempt." (2017 Omitted Property Assessment Not. (dkt. #27-1) 1-2.) The Notice further demanded payment by September 15, 2017.

In particular, the Notice explained that: (1) "[a]n adjustment was made to correct the reporting of custom software excluded . . . by including the amount of custom software in the 'System Total -- Equipment' section of the Road & Equipment schedule of the Railroad Annual Report"; and (2) "the custom software claimed as exemption . . . was determined to not qualify," so that it needed to be "added back to Wisconsin value." (*Id.* at 2.) The parties agree that DOR's disallowance of Union Pacific's custom software exemption alone resulted in $802,097.44 and $1,162,904.95 in additional taxes for 2014 and 2015, respectively, plus interest.

While the parties dispute whether Union Pacific included its custom computer software in its "total value in the first instance" (Pl.'s Resp. to Defs.' PFOF (dkt. #38) ¶ 16), there is no dispute that the

DOR's adjustments added $37,898,985 and $57,961,406 in property value for tax years 2014 and 2015, respectively, using a different valuation method than Reilly. In the end, Union Pacific opted not to pay the tax, and filed suit instead, originally suing DOR in Dane County Circuit Court on October 5, 2017, challenging the Omitted Property Assessment on state law grounds. Union Pacific then filed this federal suit on November 27, 2017. The state court stayed its proceedings pending resolution of this lawsuit.

OPINION

"The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). Here, the parties have cross-moved for summary judgment, agreeing that there are no material facts in dispute while asserting that the law is on their side. (Pl.'s Mot. Summ. J. (dkt. #24) 1-2; Defs.' Mot. Summ. J. (dkt. #33) 1.) Specifically, plaintiff argues that Wisconsin discriminates against it as a railroad in violation of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4-R Act") by taxing its custom computer software while generally declining to tax similar, intangible property owned by commercial and industrial taxpayers. On the other hand, defendants contend that Union Pacific is effectively challenging dissimilar and permissible tax exemptions granted by the State of Wisconsin to non-railroad taxpayers.

The 4-R Act prevents states from imposing on railroads: (1) greater tax rates or assessment ratios than on "other commercial and industrial property," and (2) other "discriminat[ing]" taxes against railroads. *See* 49 U.S.C. § 11503(b).[2] The Supreme Court held in *Dep't of Revenue of Ore. v. ACF Indus., Inc.*, 510 U.S. 332 (1994), that "a State may grant exemptions from a generally applicable ad valorem property tax without subjecting the taxation of railroad property to challenge under [§ 11503(b)(4)]." *Id*. at 335; *see also CSX Transp., Inc. v. Ala. Dep't of Revenue*, 562 U.S. 1101, 1106 (2011) (hereinafter "*CSX Transp. I*") (noting that in *ACF Industries*, the Court "held that a railroad could not invoke § 11501(b)(4) to challenge a generally applicable property tax on the basis that certain non-railroad property was exempt from the tax").

In *CSX Transp. I*, the Court also summarized the issue considered in *ACF Industries* as "whether a railroad could sue a State under subsection (b)(4) for taxing railroad property while exempting certain other commercial property," holding "that the railroad could not do so." 562 U.S. at 1110; *see also id.* at 1111 ("Subsection (b)(4)'s prohibition on discrimination likewise could not encompass property tax exemptions."); *id.* at 1112 ("The 4–R

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[2] "Commercial and industrial property" is defined as "property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy." 49 U.S.C § 11501(a)(4).

Act distinguishes between property taxes and other taxes. Congress expressed its intent to insulate property tax exemptions from challenge; against that background, *ACF Industries* stated that permitting such suits would intrude on the States' rightful authority. By contrast, Congress drafted § 11501 to enable railroads to contest all other tax exemptions; and when Congress speaks in such preemptive terms, its decision must govern.").

However, the Supreme Court also noted the possibility in *ACF Industries* that if the state specifically targeted the railroads for a tax not of general applicability, (b)(4) might be violated. *See CSX Transp., Inc. v. S.C. Dep't of Revenue*, 851 F.3d 320, 331 (4th Cir. 2017) (rejecting argument that *CSX Transp. I* meant that a railroad could not challenge property taxes under (b)(4)).[3] Accordingly, the Supreme Court recognized that if

> the railroads -- either alone or as part of some isolated and targeted group -- [were] the only commercial entities subject to an ad valorem property tax[,] . . . it might be incorrect to say that the State 'exempted' the nontaxed property. Rather, one could say that the State

[3] On remand, the District of South Carolina ultimately concluded that the state had discriminated against the railroad, but that the discrimination was justified because of favorable legal and practical exemptions afforded to railroads. *CSX Transp., Inc. v. S.C. Dep't of Revenue*, No. 3:14-cv-03821-MBS, 2019 WL 117313 (D.S.C. Jan. 7, 2019).

> had singled out railroad property for discriminatory treatment.

ACF Indus., 510 U.S. at 346-47 (citing *Burlington N. R.R. Co. v. City of Superior, Wis.*, 932 F.2d 1185 (7th Cir. 1991); J. Hellerstein & W. Hellerstein, State and Local Taxation 973 (5th ed. 1988)). Moreover, while the Court did not definitively resolve the reach of subsection (b)(4) because Oregon's challenged tax did not improperly single out railroad property, *id.* at 347, multiple federal courts have concluded that specific targeting of railroad property for discriminatory taxation would violate the 4-R Act.

For example, just a year later, the District of North Dakota concluded the Supreme Court had "clearly state[d] that the *ACF Industries* holding does not apply when a State targets railroads for taxation under the pretext of broad exemptions[,] . . . strongly suggest[ing] that such targeted taxation would violate the 4-R Act." *Ogilvie v. State Bd. of Equalization of State of N.D.*, 893 F. Supp. 882, 886 (D.N.D. 1995); *see also Kansas City S. Ry. Co. v. Koeller*, 653 F.3d 496, 510 (7th Cir. 2011) (recognizing this same suggestion). In *Ogilvie*, the court went on to note that the Supreme Court's use of "generally applicable" would "add nothing to [its *ACF Industries* holding] unless they form the basis of an exception." 893 F. Supp. at 886 (finding that North Dakota's tax system fell outside the *ACF Industries* holding because it exempted *all* personal property, except for *some* personal property owned

by "centrally assessed" businesses -- a short list including railroads).[4]

Where a tax is not one of general applicability, *ACF* is "inapposite." *See, e.g., Burlington N. R.R. Co. v. Bair*, 60 F.3d 410, 413 (8th Cir. 1995) (holding that "subsection (b)(4) does apply to prohibit Iowa from taxing the intangible personal property of railroads since Iowa imposes this tax upon only a small targeted group of businesses"), *cert. denied* 516 U.S. 1113 (1996).[5] In *Bair*, the Eighth Circuit concluded that "[p]ractically speaking, if a state exempts sufficient property from a particular property tax, the tax no longer can be said to be one of general application." *Id.* Otherwise, "the anti-discrimination purpose of the 4-R Act could utterly be eviscerated by a state that ostensibly imposed a tax of general applicability but then systematically exempted all but a targeted few taxpayers." *Id.*

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[4] The District of North Dakota was actually reaffirming its pre-*ACF Industries* order, adding that "*ACF Industries* continues to support the injunctions of this court." 893 F. Supp. at 886.

[5] The Eighth Circuit explained that "failure to tax non-railroad personal property is [not] the equivalent of granting an exemption" because the challenged tax "scheme does not even impose a generally applicable tax on personal property." *Bair*, 60 F.3d at 412-13.

The Tenth Circuit agrees:

> Given the Supreme Court's qualifying language in *ACF* that state tax "exemptions" denied to an "isolated and targeted group," might violate § 306(1)(d), we reject Defendant's assertion that no "property tax exemption," regardless of its nature or effect, is subject to challenge under § 306. Otherwise, states could circumvent § 306 simply by enacting a tax of "general application," and then "exempting" from the tax all but a certain class of taxpayers, which, as the Court noted in *ACF*, is really not an "exemption" at all, but a singling out of certain taxpayers for discriminatory treatment.

Burlington N. R.R. Co. v. Huddleston, 94 F.3d 1413, 1417 (10th Cir. 1996) (quoting *ACF Indus.*, 510 U.S. at 346) (holding that challenged property tax singled out plaintiff-railroad "as part of an 'isolated and targeted group' for discriminatory tax treatment in violation of § 306(1)(d) of the 4-R Act, as interpreted by the Supreme Court in *ACF*"), *abrogated in part on other grounds by Alabama Dep't of Rev. v. CSX Transp., Inc.*, -- U.S. --, 135 S. Ct. 1136, 1141 (2015) [hereinafter "*CSX Transp. II*"].[6] Further support is also found in the Seventh

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[6] However, the dissent in *Huddleston* was unconvinced that railroads were "isolated and targeted" when included in a "public utilities" group, since that group broadly included any railroad, airline, electric, telephone, telegraph, gas, gas pipeline carrier,

Circuit's *City of Superior* opinion, which as noted above, the Supreme Court cited favorably in *ACF Industries*. In *City of Superior*, the Seventh Circuit considered a Wisconsin tax on the three "iron ore concentrates docks," which were all owned or operated by railroads, concluding that the state could *only* "tax[] railroads as members of larger taxpayer groups" because "it cannot levy a tax on inputs into railroading alone." 932 F.2d at 1186, 1188.

Most recently, after considering *ACF Industries*, *Bair*, *Huddleston,* and *Ogilvie*, the District of Oregon enjoined the state "from taxing the intangible personal property of railroads" because: (1) there was no "generally applicable" tax on intangible property, as the only intangible personal property taxed was that of centrally assessed taxpayers; (2) the situation matched that reserved in *ACF Industries*; and (3) the tax scheme discriminated -- without justification -- against railroads. *BNSF Ry. Co. v. Ore. Dep't. of Revenue*, No. 3:17-cv-1716-JE, 2018 WL 6585279, at *6-*7, *11 (D. Ore. Dec. 14, 2018). That court addressed at length whether the situation identified in *ACF Industries* was still valid, concluding that it was. *Id.* at *6-*9.

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domestic water (except nonprofit domestics), pipeline, coal slurry pipeline, or private car line company. 94 F.3d at 1418-20. Here, the "isolated and targeted group" is arguably more limited because it reaches only railroads, air carriers, pipeline companies and "conservation and regulation companies." Wis. Stat. § 76.01.

Here, Chapter 70 of the Wisconsin Statutes addresses general property taxes, providing that taxes are levied "upon all general property in this state except property that is exempt from taxation." Wis. Stat. § 70.01. "General property," in turn, "is all the taxable real and personal property defined in ss. 70.03 [real property] and 70.04 [personal property], except that which is taxed under ss. 70.37 to 70.395 and ch. 76 . . . ." Wis. Stat. § 70.02. Personal property is defined to include "[a]ll goods, wares, merchandise, chattels, and effects, of any nature or description, having any real or marketable value, and not included in the term 'real property.'" Wis. Stat. § 70.04(1g). Exemptions are listed in Wis. Stat. §§ 70.11, 70.111, 70.112, including an exemption for "[m]oney and all intangible personal property." Wis. Stat. § 70.112(1).

The Wisconsin Supreme Court has further held that: "'[A]ll intangible personal property' is an exceptionally broad classification. Its plain language suggests a clear policy choice to exempt 'intangible personal property' from personal taxation." *Adams Outdoor Advertising, Ltd. v. City of Madison*, 2006 WI 104, ¶ 67, 294 Wis. 2d 441, 473, 294 N.W.2d 803, 819. Likewise, the Wisconsin Supreme Court interpreted § 70.04 as only including tangible personal property, with one exception not relevant here. *Id.* at ¶¶ 62-63. Because "all real and personal property" is to be assessed, § 70.10, there is no dispute that Chapter 70 also covers commercial and industrial taxpayers. (Defs.' Resp. to Pl.'s PFOF (dkt. #32) ¶ 14.)

In contrast, in response to questions posed by the court following summary judgment briefing, defendants acknowledged that "manufacturers do not pay property tax on intangible personal property." (Defs.' Resp. to Order (dkt. #49) 4.) On the other hand, DOR is separately charged with assessing "the property of all railroad companies, of all conservation and regulation companies, of all air carriers, and of all pipeline companies" and collecting their taxes. Wis. Stat. § 76.01.[7] Included in the taxable property are "all real and personal property of the company used or employed in the operation of its business, excluding property that is exempt from the property tax under s. 70.11(39) . . . ." Wis. Stat. § 76.025(1). While § 70.11(39) exempts "computers," "custom software" is not exempted.[8] Even so, the parties seem to agree that the Wisconsin Legislature did not intend to tax custom computer software more broadly. (*See* Pl.'s Opening Br. (dkt. #24) 18 n.5; Defs.' Opp'n (dkt. #29) 4-5; Defs.' Resp. to Order (dkt. #49) 4 ("manufacturers do not pay property tax on . . . custom software").)

Regardless, Chapter 76 provides that "both real and personal [property], including all rights, franchises and privileges used in and necessary to the

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[7] Even certain air carriers are not actually assessed under Chapter 76. *See* Wis. Stat. § 76.025(2).

[8] Defendants represent that "no property taxes are applied to non-custom software for any type of taxpayer." (Defs.' Resp. to Order (dkt. #49) 2.)

prosecution of the business of any company enumerated in s. 76.02 shall be deemed personal property for the purposes of taxation, and shall be valued and assessed together as a unit." Wis. Stat. § 76.03(1). Unlike Chapter 70, however, Chapter 76 does not exclude "all intangible personal property." As such, it appears that the only entities in Wisconsin who are taxed for their intangible personal property -- including custom computer software -- are the limited group of entities specifically assessed by DOR under Subchapter I of Chapter 76, including railroads. Accordingly, the tax on that group is *not* one of general applicability, but rather is one that appears to fall squarely, if not entirely, on railroads "as part of some isolated and targeted group." *ACF Indus.*, 510 U.S. at 346; *cf. Huddleston*, 94 F.3d at 1417 ("Unlike the tax exemption at issue in *ACF*, Colorado's intangible property tax exemption applies to *all* commercial and industrial taxpayers other than 'public utilities,'" thereby "singl[ing] out Plaintiff as part of an 'isolated and targeted group' for discriminatory tax treatment").

Similarly, the Seventh Circuit held that "railroads can only succeed [under *ACF Industries*] by showing that the actual tax levied is a general tax in name only and is in fact a tax on railroads," making "the percentage of the total tax levy that falls on railroads" the relevant number because "exempt property is not part of the comparison class." *Burlington R.R. Co. v. Wis. Dep't of Revenue*, 59 F.3d 55, 58 (7th Cir. 1995). Accordingly, the Seventh Circuit explained that "one would presumably have to look at the percentage of the total tax levy falling on the targeted group in

determining whether the tax was one of general application." *Id.* at 58 n.2.[9] On the facts before it, the Seventh Circuit went on to hold that the railroads were not specifically singled out because "the tax levy on railroad property was less than .3% of the total property tax levy; less than 1% of the property tax levy on other commercial and industrial property; and less than 5% of the levy on other commercial and industrial personal property." *Id.* at 58.

While the plaintiff-railroads in *Burlington Northern* challenged a long list of *exemptions*, here, the challenged tax on intangible personal property falls only on "public utilities" assessed under Subchapter I of Chapter 76, and the *entire* amount -- 100% -- of the taxes levied against this specific intangible property is paid by those same entities. (*See* Defs.' Resp. to Order (dkt. #49) 2 ("manufacturers do not pay property tax on intangible personal property, custom software or prewritten software").)

While the appropriate consideration for the court would appear to be the proportion of the challenged tax borne by the targeted group -- not the proportion

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[9] The Seventh Circuit declined to opine about the correctness of *Ogilvie*, choosing instead to find it "clearly distinguishable" because the challenged Wisconsin tax was "a universal tax which exempts certain classes of property," with the exemptions being independent of whether the owning business was "locally or centrally assessed." 59 F.3d at 57 n.1; *id.* at 57 (noting that statute imposed tax "upon all general property in this state except property that is exempt").

of the state's *entire* property tax collection borne by that group -- defendants represent that they are unable to apportion what part of the total assessment is "directly attributable to custom software," or even intangible or tangible personal property. (McClelland Decl. (dkt. #50) ¶ 7.) Indeed, as to railroads, DOR does not have records detailing the taxes levied on real versus tangible or intangible personal property, much less custom software alone. (Defs.' Resp. to Order (dkt. #49) 2.) Accordingly, the court is unable to determine precisely how much of the taxes levied against § 76.01 companies is attributable to the value of intangible personal property generally, or to custom software specifically. Instead, the court only has the total taxes levied against railroad and other § 76.01 companies per year:

Year	Number of Railroads Taxed under § 76.01	Amount Levied against Railroads under § 76.01	Number of Non-railroad Companies Taxed under § 76.01[10]	Amount Levied against all Companies under § 76.01[11]	Percentage of § 76.01 Taxes Levied against Railroads[12]
2008	11	$20,741,702	41	$38,501,850	54%
2009	12	$22,963,694	39	$47,402,183	48%
2010	12	$24,515,056	38	$54,413,562	45%
2011	12	$26,887,827	38	$63,220,235	43%
2012	10	$28,390,765	34	$63,900,911	44%
2013	10	$31,318,996	31	$70,902,582	44%
2014	10	$33,903,738	32	$74,599,100	45%
2015	10	$36,782,519	31	$78,767,828	47%
2016	10	$43,991,610	31	$89,249,784	49%
2017	10	$41,637,819	32	$93,655,217	44%
2018	10	$42,581,886	31	$93,926,686	45%

[10] These numbers include the conservation and regulatory companies, air carriers, and pipeline companies taxed under § 76.01. (McClelland Decl. (dkt. #46) 3-4.)

[11] These amounts include the levies against railroads. (*Id.* at 2.)

[12] These percentages are calculated by dividing the amount levied against railroads by the amount of taxes levied against all Companies under § 76.01.

If the total property taxes levied are any indication, railroads roughly shoulder between 40 and 55% of the taxes on custom software. This disproportionate tax burden is very different from the relatively slight tax burdens borne by the railroads in *Burlington Northern*. *Cf.* 59 F.3d at 58 (explaining railroads' tax levy comprised "less than .3% of the total property tax levy; less than 1% of the property tax levy on other commercial and industrial property; and less than 5% of the levy on other commercial and industrial personal property").

Moreover, defendants provide no justification for singling out the custom computer software of railroads, airlines and public utilities alone for taxation, leaving the court to conclude that this disproportionate tax burden on that narrow class of taxpayers is a violation of § 11501(b)(4). Accordingly, Union Pacific has established a violation of the 4-R Act because railroads, as part of a small group of companies, are taxed on their custom computer software, unlike other industrial or manufacturing taxpayers.

ORDER

IT IS SO ORDERED that:

(1) Plaintiff's motion for summary judgment (dkt. #24) is GRANTED.

(2) Defendants" motion for summary judgment (dkt #33) is DENIED.

(3) Defendants are enjoined from assessing or collecting a tax on Union Pacific's custom computer software under Chapter 76 of the Wisconsin Statutes. The parties may have fourteen (14) days to meet and confer on the appropriate form of a permanent injunction, at which point they are to jointly submit a proposed injunction. Failing that they are to submit separate proposals, along with a brief explanation as to why their proposal is preferable.

Entered this 5th day of March, 2019.

BY THE COURT:

/s/

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WILLIAM M. CONLEY
District Judge